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Supreme Court of the United States

October Term, 1969

No. 925

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,

Petitioners,

—v.—

LAW RESEARCH SERVICE, INC. and ELLIAS C. HOPPENFELD,

Respondents,

and

BLAIR & CO., GRANBERY MARACHE INCORPORATED,

Respondent and Third-Party Plaintiff,

—v.—

PAUL WIENER,

Third-Party Defendant.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Supreme Court of the United States

October Term, 1969

No.

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,

Petitioners,

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LAW RESEARCH SERVICE, INC. and ELLIAS C. HOPPENFELD,

Respondents,

and

BLAIR & CO., GRANBERY MARACHE INCORPORATED,

Respondent and Third-Party Plaintiff,

v.

PAUL WIENER,

Third-Party Defendant.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review so much of the judgment of the United States Court of Appeals for the Second Circuit which reversed on the law that part of the United States District Court's judgment granting plaintiffs punitive damages.

Opinions Below

The opinion of the Court of Appeals reversing the award of punitive damages and in all other respects affirming the judgment of the District Court, printed in the Appendix hereto, has not yet been officially reported. The opinion of the District Court for the Southern District of New York, also printed in the Appendix, is reported at 287 F. Supp. 188.

Jurisdiction

The date of the judgment of the Court of Appeals for the Second Circuit sought to be reviewed and the date of its entry is September 8, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

The grounds upon which the jurisdiction of this Court is invoked are: (1) the Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court; (2) that decision ignores and is in apparent conflict with the teachings of decisions of this Court; (3) that decision creates uncertainty in that it is inconsistent with decisions of District Courts in other Circuits.

Questions Presented

1. Whether in an appropriate case punitive damages are available as a remedy for a violation of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a).

2. As a corollary question, although not vital to a determination of the primary question, whether in an appropriate case punitive damages are available as a remedy for a violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

Statutes Involved

The statute involved is § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), which provides:

> "It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—(1) to employ any device, scheme or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Section 10(b) of the Securities Exchange Act of 1934 reads:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange,—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. § 240.10b-5, reads:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange.
>
> (a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Statement

This is an action by thirteen plaintiffs under the anti-fraud provisions of the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act) against Law Research Service, Inc. (LRS), its president and controlling person, Ellias C. Hoppenfeld (Hoppenfeld), and Blair & Co., Granbery, Marache, Incorporated (Blair). The District Court had jurisdiction under 15 U.S.C. § 77v and 15 U.S.C. § 78aa. LRS (a close corporation) was the issuer of 100,000 shares of its common stock offered under Regulation A of the Securities and Exchange Commission (SEC) 17 C.F.R. §§ 230.251 *et seq.*, and Blair was the underwriter. The complaint alleged violations by the defendants of § 17(a) of the 1933 Act, § 10(b) of the 1934 Act, and the commission of common law fraud. Additionally, the complaint alleged violations by Blair of § 12(2) of the 1933 Act,* 15 U.S.C. § 77 1(2), and § 15(c) of the 1934 Act, 15 U.S.C. § 78o(c).

The jury found that said defendants had violated §§ 17(a) and 10(b), but had not committed common law fraud. It also found that Blair had violated §§ 12(2) and 15(c). The jury awarded the plaintiffs (most of whom

* Plaintiffs consented to a dismissal at trial of their alleged count under § 12(1) of the 1933 Act in order to clarify the issues for the jury.

could be characterized as small investors (A-33))* an aggregate of $32,591.14 in compensatory damages (including legal interest) against said defendants and punitive damages against Hoppenfeld in the amount of $26,812.06 and Blair in the amount of $13,000 based solely on the violation of § 17(a) of the 1933 Act.** Both the Trial Court (A-14-15) and the Court of Appeals (A-39, fn. 10) found the jury's punitive damages award to be moderate.*** No punitive damages were awarded against LRS.

The essence of the complaint was that plaintiffs purchased their shares of LRS stock in reliance on a prominent representation in the Offering Circular, prepared by the defendants and distributed to the public under Regulation A, that LRS had an exclusive five year contract with the Univac Division of the Sperry Rand Corporation (Sperry) whereunder Sperry was to perform certain functions and services necessary to the operation of LRS' business, a computerized information retrieval system for commercial use by lawyers to aid them in their legal research. That representation was false and misleading in that it omitted to state that since January 29, 1965 and continuing up to the date the offering of the shares became effective, March 15, 1965, and beyond: (1) Sperry had terminated its contract with LRS; (2) Sperry refused to perform further vital services; and, (3) LRS had instituted a lawsuit against Sperry in the Supreme Court of the State of New York in which it filed an affidavit swearing that the lawsuit

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* A and number designates page in the appendix herein.

** The Trial Court had instructed the jury that punitive damages were awardable under the 1933 Act, but not under the 1934 Act. Plaintiffs argued at trial that punitive damages were also awardable under the 1934 Act, but, naturally, did not appeal that ruling in view of the jury's favorable award under the 1933 Act.

*** The Court of Appeals took no exception to the Trial Court's charge to the jury as to the type of conduct which would warrant the imposition of punitive damages; it made footnote reference, however, to the "conundrum" of which law of punitive damages is applicable, state or federal common law (A-41, fn. 13).

was for breach of contract, fraud and deceit, specific performance and conspiracy.

The Court of Appeals thought the omission "startling" (A-31). It found the evidence adequate to support the jury's finding of a misleading omission of a material fact and ample to support the conclusion that Blair had knowledge of the dispute (A-33). However, it held that "punitive damages may not be recovered under § 17(a)" (A-24).

Reasons for Granting the Writ

1. The Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

The importance of the question is recognized by the Court of Appeals, whose opinion begins:

> This tortuous litigation raises at least two issues of great importance: are punitive damages available in private actions based on Section 17(a) of the Securities Act of 1933, . . ." * (A-24).

It later states:

> "This appears to be the first occasion on which punitive damages have actually been awarded for a violation of the Securities Acts." (A-34).

It concludes its opinion by characterizing the questions raised on appeal as being "novel and important". (A-51).

The preeminent rationale underlying the holding of the Court of Appeals that punitive damages are not recoverable is its self-stated reliance "on an analysis of the role

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* The other issue concerns cross-claims filed by the defendants against each other respecting the underwriter's indemnification agreement, and is not pertinent to this petition.

punitive damages would play in the statutory scheme established for the enforcement of the Securities Act." (A-36). It asserts that "The seminal question is whether punitive damage recovery is necessary for the effective enforcement of the Act." (A-37). It is respectfully submitted that the determination of that question should be made by the Supreme Court in view of the plethora of securities acts lawsuits now abounding.

Moreover, it would appear that the Court of Appeals' determination in the instant case was sharply influenced by its own decision and the rationale thereof in *Green* v. *Wolf Corp.*, 406 F. 2d 291 (1968), cert. denied 395 U.S. 977 (1969) that punitive damages are not available for violations of § 10(b) of the 1934 Act (A-34).* (The Petition for Certiorari in *Green* v. *Wolf* was not on the issue of punitive damages.) It would thus appear as a corollary that the guidance of this Court on the issue of punitive damages is necessary also with respect to § 10(b) of the 1934 Act and the meaning of § 28(a) of that Act, 15 U.S.C. § 78bb(a). (See A-39).

2. The Court of Appeals' decision ignores and is in apparent conflict with the teachings of decisions of this Court.

In assessing the "statutory scheme", the Court of Appeals relies on the "arsenal of weapons" available under the securities acts, including their express criminal, injunctive and administrative remedies, as well as private actions (A-37). It fears the "overkill" danger of punitive damages, (A-39, fn. 10), and cautions against providing a "windfall" to an early litigant. (A-39). In short, it holds

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* In *Green* v. *Wolf*, the Court of Appeals stated with respect to punitive damages under the 1933 Act: "It is true that punitive damages are permitted under the Securities Act of 1933, but that Act does not contain language similar to Section 28(a) of the 1934 Act." At 406 F. 2d 303. It now distinguishes that contrary language as "dicta". (A-40, fn. 12).

that there can never be an appropriate case for punitive damages under the Securities Acts. It thus ignores the teachings of this Court (argued in plaintiffs' brief) in *J.I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), involving the 1934 Act, that one of the chief purposes of that Act is "the protection of investors", and that private action is an effective enforcement weapon and a necessary supplement to Commission action. (At 377 U.S. 432). *Case* v. *Borak* also teaches that federal courts should " 'adjust their remedies so as to grant the necessary relief' " against the invasion of federally secured rights, and in such case where " 'a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.' ". At 377 U.S. 433, citing *Bell* v. *Hood,* 327 U.S. 678, 684 (1946). *Case* v. *Borak* also quotes from this Court's decision in *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282 (1940) involving the 1933 Act, that " '. . . the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case.' ". At 377 U.S. 434. An action for punitive damages is normally available to a litigant in an appropriate case.

The Court of Appeals likewise ignored the teaching of *S.E.C.* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180 (1963), (likewise argued), that Congress intended the securities legislation, enacted for the purpose of avoiding frauds, to be construed " 'not technically and restrictively, but flexibly to effectuate its remedial purposes.' ". At 375 U.S. 195. (See also the opinion of the Trial Court, (A-10)).

The Court of Appeals' concern with "overkill" and "windfall" would appear to be at variance with the overall purposes of the Securities Acts, the protection of investors, and the deterrence of "fraudulent conduct of a heinous character." (A-10). The defendants in this case made extremely profitable gains from their wrongdoing (R. 86,

95-99, 447-448, 855).* The S.E.C., with knowledge of the facts, merely required an utterly ineffective post-distribution letter to be sent to all stockholders, unless it meant to alert investors to their right of private action (A-32, and fn. 7 thereon). See *Case* v. *Borak,* at 377 U.S. 432.

3. The Court of Appeals' decision creates uncertainty.

In *Hecht* v. *Harris, Upham & Co.,* 283 F. Supp. 417 (1968), the District Court for the Northern District of California permitted an action for punitive damages under § 10(b) of the 1934 Act. The District Court for the District of Colorado, with knowledge of the Court of Appeals' decision in *Green* v. *Wolf, supra,* expressly disagreed with it and denied a motion to set aside a jury's award of punitive damages under Section 10(b), *de Haas* v. *Empire Petroleum Co.,* 302 F. Supp. 647 (1969). In the light of the Court of Appeals' reliance on its own thinking in *Green* v. *Wolf,* a 10(b) case, to arrive at its determination in a 17(a) case and that Court's "dicta" in *Green* v. *Wolf* that punitive damages are recoverable under 17(a), the 10(b) decisions in the cited District Court cases raise an aura of uncertainty in the Circuits. Moreover, the District Court for the Northern District of Ohio has indicated that punitive damages are recoverable under 17(a), *Nagel* v. *Prescott & Co.,* 36 F.R.D. 445 (1964). Nor should the scholarly opinion of Judge Mansfield, the Trial Court, be disregarded.

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* Reference is to pages in official trial transcript.

Conclusion

Because the Court of Appeals has decided an important question of federal law in a recent and burgeoning field of litigation, and because the effect of that decision is in conflict with the previous prescriptions of this Court, as well as with the decisions of District Courts in various Circuits, thereby creating an area of uncertainty, it is respectfully submitted that a writ of certiorari should be granted as requested.

Dated: New York, N. Y.
December 5, 1969

Respectfully submitted,

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APPENDIX

Decision of the United States District Court for the Southern District of New York

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

'65 Civ. 1694

—o—

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ATENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN, and CHARLES SEMENETZ, JR.,

Plaintiffs,

against

LAW RESEARCH SERVICE, INC. and ELLIAS C. HOPPENFELD,

Defendants,

and

BLAIR & CO., GRANBERY, MARACHE INCORPORATED,

Defendant and Third Party Plaintiff,

against

PAUL WIENER,

Third Party Defendant.

—o—

Appearances:

COOPER, OSTRIN, DEVARCO & ACKERMAN, Attorneys for Plaintiff, 655 Madison Avenue, New York, N. Y. 10021.

Decision of the United States District Court for the Southern District of New York

JULIEN, GLASER & BLITZ, Attorneys for Defendants Law Research, Hoppenfeld and Wiener, 2 Lafayette Street, New York, N. Y.

NIXON MUDGE ROSE GUTHRIE ALEXANDER & MITCHELL, Attorneys for Defendant Blair & Co., Granbery, Marache Incorporated, 20 Broad Street, New York, N. Y.

MANSFIELD, *D.J.*:

In this action by 13 purchasers of an issue of common stock of Law Research Service, Inc., the complaint charged Ellias C. Hoppenfeld, its President, and Blair & Co., Granbery, Marache Inc., the underwriter of the issue, in three counts with violations of § 17(a) of the Securities Act of 1933, § 10(b) of the Securities Exchange Act of 1934, and common law fraud, and Blair & Co. in two counts with violation of § 12(2) of the 1933 Act and § 15(c) of the 1934 Exchange Act. The jury awarded compensatory damages against all defendants on all counts except the common law fraud counts (as to which it returned a verdict for the defendants) and punitive damages against Hoppenfeld and Blair & Co. on the count charging them with violation of § 17(a) of the 1933 Act.

Cross-claims were also asserted under an indemnity agreement by defendants Law Research Service, Inc. and Hoppenfeld against Blair & Co., and by Blair & Co. against them and a third party defendant, Paul Wiener. Disposition of these cross-claims was deferred pending the jury's verdict, following which the said defendants and third party defendant moved to dismiss the cross-claims. Reserving decision on that motion, this Court submitted the issue of liability on the cross-claims to the jury which found against Law Research Service, Inc. and Hoppenfeld, and in favor of Blair & Co., whereupon Law Research Service, Inc., Hoppenfeld and Wiener moved, pursuant to Rule 50(b),

F.R.C.P., to set aside the verdict and for judgment notwithstanding the verdict. For the reasons hereafter set forth, the motions of the said defendants are granted.

The lawsuit arises out of a public offering of 100,000 shares of the common stock of Law Research Service, Inc. pursuant to a Regulation A exemption from registration, in connection with which an Offering Circular admittedly prepared by the defendants and bearing the name of Blair & Co. was distributed to the public. Law Research Service, Inc., which commenced operations in 1964, was engaged in the business of operating a law information retrieval program for the legal profession by applying computer technology to the problems of legal research. In order to carry out its operations, it entered into an exclusive five-year contract, dated June 5, 1963, with the Univac Division of the Sperry Rand Corporation, which obligated Sperry Rand to provide programming, Sperry Rand's Univac III compute time, and certain other services, all at costs set forth in the contract.

In offering the new issue on March 15, 1965 to the public, the Offering Circular referred prominently (on page 5) to "the Sperry Rand contract", which was obviously an attractive feature to the public, since the name Sperry Rand is widely known to the public as a leader in the computer field. Although the Circular described in several paragraphs the Sperry Rand Law Research contract, it misrepresented the relations between the two companies under the contract by omitting mention of the fact that on January 25, 1965, Sperry Rand had written a letter to Law Research terminating the contract effective January 29, 1965 for non-payment of a balance of more than $82,000. The Circular also omitted mention of the important fact that following the termination letter Law Research had instituted a lawsuit in the New York County Supreme Court against Sperry Rand by service of summons upon it and various of its officials and on February 23, 1965, it

filed in that lawsuit an affidavit sworn to by its Treasurer and Director, Wiener, swearing that the lawsuit was for breach of contract, fraud and deceit, specific performance and conspiracy. Lastly the Offering Circular omitted entirely any mention of the equally material fact that from January 29, 1965 until at least the date of the Offering Circular (March 15, 1965), and for sometime thereafter, Sperry Rand was refusing to furnish vital services to Law Research pursuant to the contract.

The plaintiffs testified that they purchased shares of the new issue of Law Research stock in reliance upon the description of the contract with Sperry Rand, a name which many of them knew favorably as a national concern, and that they would not have purchased their stock if they had known of the termination, lawsuit and refusal to furnish services, since the contract with Sperry Rand was understandably viewed by them as a very important factor in leading them to buy Law Research stock.

In addition to seeking compensatory damages the complaint sought punitive damages against all of the defendants, alleging that they had acted fraudulently, wantonly and with reckless disregard for the consequences of their conduct and that they had committed a gross fraud, involving high moral culpability that was aimed at the public generally. Judged by such well-established criteria there was ample evidence to support an award of punitive damages against Hoppenfeld and Blair & Co. There is no dispute about the fact that Hoppenfeld was fully aware of the termination letter, the lawsuit and Sperry Rand's refusal to render services, and that he omitted these most material facts from the Notification and Offering Circular, obviously for the reason that if the facts had been revealed to the public, it might have been difficult, if not impossible, to induce the public to invest in the new issue. Although Hoppenfeld was undoubtedly the primary wrongdoer, there was ample evidence in the record to support a finding that

Blair & Co. also had knowledge of the essential, material facts omitted from the Offering Circular and was guilty of deliberate wrongdoing in distributing the Circular without revealing these facts. Hoppenfeld testified, for instance, that he furnished the essential facts both to Blair & Co. and Arthur Young & Co., Certified Public Accountants, who were brought by it into the picture to conduct the audit and handle accounting matters in connection with the new issue.*

Although Hoppenfeld at trial first indicated reluctance to implicate Blair & Co., he did eventually testify flatly that in February 1965 he advised Mr. Sanders of Blair & Co., who was in charge of the issue, about the lawsuit that had been begun on Janary 29, 1965 against Sperry Rand. (See stenographic minutes, pages 145 to 149.) In addition to such direct testimony, there was considerable evidence from which an inference of knowledge on Blair & Co.'s part could be drawn, including repeated references to a lawsuit in February 1965 correspondence between Hoppenfeld and Arthur Young & Co. and specific references in such correspondence and communications to the Sperry Rand termination letter of January 25, 1965.

In view of the fact that there was evidence from which an inference of fradulent, wanton and willful misconduct involving high moral culpability and disregard for the public could be drawn, *Walker* v. *Sheldon*, 10 N.Y. 2d 401, 223 N.Y.S. 2d 488, 179 N.E 2d 497 (1961); *Roginsky* v. *Richardson-Merrell, Inc.*, 378 F.2d 832 (2d Cir. 1967); *Smith* v. *Little, Brown & Co.*, 273 F. Supp. 870 (S.D.N.Y. 1967), the Court submitted to the jury the question of whether punitive damages should be awarded. In its original charge

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* Arthur Young & Co. were accountants for both Blair & Co. and its law firm in charge of the handling of the underwriting, Nixon Mudge Rose Guthrie Alexander & Mitchell.

the Court instructed the jury that such damages could be awarded only for conduct deemed to be against the public interest which involved high moral culpability and acts that were the result of gross fraud. (See Appendix A hereto.) *Walker* v. *Sheldon,* 10 N.Y. 2d 401, 405 (1961). At the time when these instructions were given, there was submitted to the jury not only the claims based on alleged violations of §§ 12(2) and 17(a) of the 1933 Act and §§ 10(b) and 15(c) of the 1934 Act, but also a count charging common law fraud in violation of New York law.

During the course of its deliberations, the jury sent out a note inquiring whether it must find common law fraud in order to award punitive damages. The Court then instructed the jury as follows:

> "I have already instructed you that punitive damages are intended to penalize or punish a defendant for certain kinds of conduct deemed to be against the public interest which involve a high moral culpability.
>
> "Now, the standard for determining whether or not punitive damages should be imposed in any case such as this is not whether the technical requirements of common law fraud as distinguished from Federal Securities Law fraud are established, the standard is whether the conduct of a defendant involved a high degree of moral culpability of a type that would in effect constitute moral turpitude or dishonesty and a wanton indifference to one's obligations.
>
> "Now, having that standard in mind, it, of course, would be much more likely that one would have to find an intent to defraud in order to find any punitive damages. However, I pointed out that there was one other difference between common law fraud and the Federal Securities Act fraud and that

is that the reliance is slightly different. The reliance under common law fraud has to be what is called justifiable reliance as distinguished from the standard that I mentioned earlier, which was whether or not the plaintiff, if he had known the omitted facts, would have been likely to take a different course of action or whether the plaintiff would have been influenced to act differently than he did act if the defendants had disclosed to him the omitted facts.

"Punitive damages are not recoverable under one of the Securities Acts involved, known as the 1934 Act. However, there is nothing to preclude recovery of them in a suit under the other Federal Security Act known as the 1933 Act.

"So what I am saying to you is that while it would be much more likely that you would have to find an intent to defraud before you could find punitive damages, that is not an absolute requirement. The test is whether there is high moral culpability or such gross fraud and deceit upon the public that it shows, evinces, what somebody has described as moral turpitude or such a wanton dishonesty as to imply an indifference to one's obligations.

"I think that is the best I can give you on this subject. If it is inadequate, you may request more and I will do my best."

There followed a verdict against the defendants on all charges of violation of the federal securities laws and a verdict in favor of the defendants on the count charging common law fraud. Defendants' motion to dismiss the award of punitive damages against Hoppenfeld and Blair & Co. on the ground that such damages could not be awarded in a civil suit for violation of the federal securities laws was denied. Although § 28(a) of the 1934 Exchange

Act, 15 U.S.C. § 78bb(a) prohibits an award of damages "in excess of . . . actual damages on account of the act complained of", no such prohibition is found in the 1933 Act. Congress' decision thus to limit the prohibition to the 1934 Exchange Act appears to have been deliberate. It could, of course, have added a similar provision to the 1933 Act, but it chose not to do so. One reason was that in adopting the 1934 Exchange Act it was faced with a unique problem not encountered in the earlier law. Since the 1934 Exchange Act was to apply only to post-distribution trading of securities listed on national exchanges, issuers could avoid its provisions, at least as far as new issues were concerned, simply by not listing them on such exchanges. In order to avoid such a "strike" Congress imposed less burdensome requirements and standards in the 1934 Exchange Act upon issuers than those found in §§ 11 and 12 of the 1933 Act, which could not easily be avoided by issuers, since the 1933 Act dealt with the distribution of securities, whether or not listed on an exchange, through use of the mails, telephone or any interstate instrumentality or facility. The selective and limited applicability of § 28(a) of the 1934 Exchange Act was part and parcel of this legislative design.

There remains the question of whether fraud in violation of § 17(a) of the 1933 Act should be treated differently, at least for purposes of permitting imposition of punitive damages, than traditional common law fraud. The mere fact that liability arises out of a statutory violation does not require express legislative authority permitting such damages. *Mansell* v. *Saunders,* 372 F.2d 573, 576 (5th Cir. 1967) (punitive damages recoverable in action under Civil Rights Act § 1983); *Basista* v. *Weir,* 340 F.2d 74, 84-88 (3d Cir. 1965); *In re Den Norske Amerikalinje A/J,* 276 F. Supp. 163, 176 (N.D. Ohio 1967) (punitive damages recoverable in action under Jones Act); but see *Burris* v.

International Brotherhood of Teamsters, 224 F. Supp. 277 W.D. N.S. 1963) (punitive damages not recoverable under Labor Management Reporting and Disclosure Act). In fact there are not even express statutory provisions creating civil liability, much less authorizing an award of compensatory damages in a civil suit based on a violation of § 17(a). Yet the violation of that section, like a violation of § 10(b) of the 1934 Exchange Act, is recognized as giving rise, under basic common law tort principles, to civil liability in favor of those intended to be protected by the statute—in this case the victims of the fraud—and to be awarded damages. *Dack* v. *Shanman,* 227 F. Supp. 26, 28-29 (S.D. N.Y. 1965); *Thiele* v. *Shields,* 131 F. Supp. 416, 419 (S.D. N.Y. 1955); III Loss, Securities Regulation 1784-91 (1961 ed.); Bromberg, Securities Law Fraud ¶ 2.5(1) n. 105. The right of the victims to sue, and to be awarded damages, is implied, not expressed in the statute itself.

To award compensatory damages for violation of § 17(a), the jury was instructed that it must find that the defendants made (1) false or misleading statements (2) with respect to material facts (3) with knowledge that the statements were false or misleading, or of the existence of facts which, if disclosed, would reveal them to be false or misleading, and that (4) the plaintiffs relied upon the statements as substantial factors in determining their course of conduct (as distinguished from "justifiable" reliance), (5) with resulting damage. The jury was further instructed that if, in addition to these elements it found that the fraudulent conduct involved a "high degree of moral culpability," "wanton dishonesty," "moral turpitude," "gross fraud and deceit upon the public," and a "wanton indifference to one's obligations," punitive damages might be awarded in addition to compensatory damages. Since there was evidence to support such findings and we must at this stage assume that the jury so found, the nature of the conduct appears to be appropriate for such

an award under § 17(a) of the Securities Act of 1933. See *Nagel* v. *Prescott & Co.*, 36 F.R.D. 445 (N.D. Ohio 1964), but see *Shonts* v. *Hirliman*, 28 F. Supp. 478 (S.D. Cal. 1939).

An award of punitive damages as a means of deterring fraudulent conduct of a heinous character, such as was found by the jury here, also accords with the overall purpose of the anti-fraud provisions of the 1933 Act. In enacting that statute Congress declared war upon practices that would deceive investors, and to this end equipped the Securities and Exchange Commission, the Department of Justice, and the investing public with an arsenal of legal weapons designed to instill honesty and fair dealing among issuers, underwriters, dealers and others who issued, distributed and traded in securities. See *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1964); Douglas and Bates, The Federal Securities Act of 1933, 43 Yale L.J. 171, 182 (1933). With a view toward effectuating these broad remedial purposes, the judiciary has endeavored to answer the multitude of not specifically resolved questions that arise under these enactments. See, e.g., *J. I. Case* v. *Borak*, 377 U.S. 426 (1964); *SEC* v. *Capital Gains Research Bureau, Inc., supra.*

In addition to deterring fraud generally in the sale of securities, punitive damages serve the desirable function, certainly in cases involving limited amounts of compensatory damages (such as that here) of insuring that victims of a scheme to defraud who purchased only a small number of shares pursuant to a Regulation A offering (100,000 shares or less) will not find themselves without an effective legal remedy. Compare *Missouri Pac. Ry.* v. *Humes*, 115 U.S. 512, 523 (1885). Moreover, as Judge Fuld put it in *Walker* v. *Sheldon*, 10 N.Y.2d at 406, 223 N.Y.S.2d at 492, limiting the judgment to compensatory damages

> "would require the offender to do no more than return the money which he had taken from the

> plaintiff. In the calculation of his expected profits, the wrongdoer is likely to allow for a certain amount of money which will have to be returned to those victims who object too vigorously and he will be perfectly content to bear the additional cost of litigation as the price for continuing his illicit business. It stands to reason that the chances of deterring him are materially increased by subjecting him to the payment of punitive damages."

See *Fishman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951).

Defendants contend that since the jury found for the defendants on the common law fraud claim, punitive damages could not be awarded against them for violation of § 17(a) of the Securities Act of 1933. This would require that a plaintiff establish (1) justifiable reliance, necessary in a common law deceit action, rather than the federal securities law fraud's actual reliance test, i.e., that plaintiff would have been influenced to act differently than he did if the defendant had disclosed the omitted fact; and (2) a specific "intent to defraud" as distinguished from actual knowledge of a statement's material falsity or of facts showing it to be false or misleading, notwithstanding the existence of a general fraudulent purpose aimed at the public as a whole, or wanton and reckless conduct evidencing a deliberate disregard for one's own obligations or the interest of others. However, as already noted, the concept of punitive damages has never been so narrowly limited. Its purpose is to deter and punish a wide range of anti-social conduct, including not only intentionable wrongs (e.g., assault, defamation, seduction), but also wanton and reckless conduct, such as drunken driving that injures another, *Miller* v. *Blanton*, 213 Ark. 246, 210 S.W.2d 293 (1948), the maintenance of a nuisance, *Reynolds Metals Co.* v. *Lampert*, 316 F.2d 272, 275 (9th Cir. 1963),

defamation, *Penn-Ohio Steel Corp.* v. *Allis Chalmers Mfg. Co.*, 272 N.Y.S.2d 266, 289-90 (Sup. Ct., N.Y. Co., 1966), the unreasonable refusal to sell a ticket, *Pittsburgh, C. & St. L. Ry.* v. *Lyon*, 123 Pa. 140, 16 Atl. 607 (1889), see McCormack, Damages, §§ 79, 81 (1935), or fraud, *Walker* v. *Sheldon, supra.* Although an "intent to defraud" i.e., a design to "cheat" or to "hoodwink," or to deprive another of something of value, see *Weber* v *C..M.P. Corp.*, 242 F. Supp. 321, 324-25 (S.D.N.Y. 1965), will support a verdict of punitive damages, there are also others that will suffice. For example, where a defendant brazenly embarks on a venture to reap profits on the basis of a knowing false statement, unmindful of consequences to others, he too may be held liable for punitive damages despite his absence of a specific intent to cheat a particular person. *Walker* v. *Sheldon, supra* (punitive damages may be awarded against one who has deliberately and wantonly engaged in a far-flung fraudulent scheme, systematically conducted for profit). Whether the victim is a gullible innocent or a shrewd investor is not terribly significant in judging the character of conduct on a defendant's part that should be deterred. Therefore, provided plaintiff can establish wanton dishonesty, high moral culpability and a gross fraud aimed at the public generally, as he has done here, punitive damages can be awarded for violation of § 17(a) of the 1933 Act, even in a case in which plaintiff has not brought himself within the technical elements of common law deceit. Moreover, there is no merit in the assertion that the Court's instruction departed from "the close to criminal" standard, since the substance of the charge repeatedly brought out that defendants' conduct had to involve high moral culpability and wanton dishonesty.

A third contention is that since plaintiffs maintained their action for violation of § 10(b) of the 1934 Act, they gave up any right to recover anything in excess of actual

damages. They base their argument upon § 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a) which provides that "[n]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of." Since the defendants' acts which brought forth the § 17(a) claim were identical to those which led plaintiffs to sue under § 10(b) of the 1934 Act, so the argument runs, plaintiffs, having been permitted to sue under the 1934 Act must be limited in their recovery to "actual damages," i.e., no punitive damages.

While the contention is an interesting one, defendants' position cannot succeed because it overlooks the first clause of § 28(a) which provides:

> "The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity. . . ."

This clause has as its purpose to insure that the 1934 Act creates *additional* rather than exclusive remedies to those who have been victimized and misled in the purchase of securities. *Errion* v. *Connell,* 236 F.2d 447 (9th Cir. 1956). Among the other remedies available to such plaintiffs is a common law deceit action and an action based on violation of § 17(a) of the 1933 Act, with their possibilities of punitive damages.

Defendants' position, if accepted, would force plaintiffs, either prior to or during litigation, to choose between common law remedies with their different proof requirements, and § 10(b) and Rule 10b. While a defrauded purchaser could avoid these difficulties by keeping free of the 1934 Act and joining a common law fraud claim with one under § 17(a) of the 1933 Act, 15 U.S.C. § 77q(a), a defrauded seller would not be so fortunate, because § 17(a)

is not available to one in his position. Such a result would resurrect from the depths the long-since repudiated "election of remedies" doctrine. See Clark, Code Pleading § 77 (1947). This Court is loathe to believe that Congress, in enacting the 1934 legislation, intended to create such a procedural morass for those victimized by securities frauds. Moreover, the one case where the issue was presented rejected such a contention. *Gann* v. *Bernzomatic Corp.*, 262 F. Supp. 301, 304 (S.D.N.Y. 1966) (McLean, J.). In the light of the foregoing, the second clause of § 28(a), 15 U.S.C. § 78bb(a), should be read only as indicating that in no event shall double compensatory damages be recovered by reason of the fact that plaintiff alleges alternative theories for relief, III Loss, Securities Regulation 1474 n. 105 (1961 ed.); and that punitive or exemplary damages are not recoverable for violation of the Securities Exchange Act of 1934. *Meisel* v. *North Jersey Trust Co.*, 218 F. Supp. 274, 216 F. Supp. 469 (S.D.N.Y. 1963); *Pappas* v. *Moss*, 257 F. Supp. 345 (D.N.J. 1966).

Defendants also argue that since the jury's verdict did not distinguish between the §17(a) claim under the 1933 Act, and the §10(b) count under the 1934 Act, the punitive damages award cannot stand. This contention borders on the frivolous for the reason that the elements of both causes of action are the same in a case involving a defrauded purchaser, so that the jury, in finding a violation of § 17(a), necessarily found one of § 10(b). Furthermore, the Court charged that punitive damages could be awarded only for violation of the 1933 Act, and not for the 1934 Act, see Bromberg, Securities Law Fraud §9.1 n. 20, and the jury found all securities acts to have been violated. The defendants were therefore not prejudiced by lumping of the verdicts based on violation of the federal securities act.

It is significant, in reviewing defendants' contentions as to punitive damages, that when faced with a gross securities fraud aimed at the public generally, the jury leniently as-

sessed such damages, including counsel fees, in a total amount of $26,800 as against Hoppenfeld, and $13,000 as against Blair & Co., while finding compensatory damages in the amount of $27,600. Moreover, the jury sensibly refused to assess punitive damages against defendant Law Research, apparently for fear that plaintiffs might gain at the expense of other stockholder-victims who neglected to pursue their claims.

Defendants next contend that the instruction given with respect to the knowledge necessary to support an action under § 17(a), § 10(b) and Rule 10b-5 was in error. The Court charged that the jury had to find that

> "[T]he defendant either knew that the statement was misleading or knew of the existence of facts which, if disclosed, would have shown it (the statement) to be misleading."

In short, actual knowledge of the misleading nature of the statement was an essential to liability. However, defendants say that more is required, and that the jury should have been required to find not only that the defendants had knowledge of the falsity of their statements, but also that they had an intent to deceive, to cheat, and to hoodwink.

At the moment, this is an issue which has caused considerable debate among the judges in this district as well as among the solons of academia. *Compare Gould* v. *Tricon, Inc.*, 272 F. Supp. 385 (S.D.N.Y. 1967) (Tenney, J.) (fraudulent conduct essential) *and Weber* v. *C.M.P. Corp.*, 242 F. F. Supp. 321 (S.D.N.Y. 1965) (Wyatt, J.) (deception in the sense of "cheating" or "hoodwinking" essential) *with Richland* v. *Crandall*, 262 F. Supp. 538, 553 n. 12 (S.D.N.Y. 1967) (myself) (guilty knowledge will suffice), *and with Dack* v. *Shanman*, 227 F. Supp. 26 (S.D.N.Y. 1964) (McLean, J.) (irrespective of defendant's intent, allegation of untrue material statement or material omission withstands

motion to dismiss). As to the debate among the academicians, compare Cohen, "Truth in Securities" Revisited, 79 Harv. L. Rev. 1340, 1364-66, 1369-70 n. 89 (1966) ("manipulative" or "deceptive" conduct should be prerequisite); III Loss, Securities Regulation 1766 (1961 ed.) (watered-down *scienter* element); Jennings, Insider Trading in Corporate Securities, 62 Nw. L. Rev. 809, 818-19 (1968) (scienter essential except where plaintiff and defendant are fiduciaries); Note, Civil Liability under Section 10B and Rule 10B-5, 74 Yale L.J. 658, 682-90 (1965) (liability for negligent, though not innocent, misstatements suggested).

Thrust as we are into the fray, it appears to us inescapable that an implied private civil action under § 10(b) requires the existence of at least "manipulative" or "deceptive" conduct or a "contrivance" in order to fall within the congressional mandate. Moreover, while § 17(a)(2) proscribes *any* untrue statement of a material fact or omission to state a material fact, regardless of the maker's intent, it does not appear inappropriate to require that a private plaintiff demonstrate something more than a negligent misstatement, in view of the existence of §§ 11 and 12(2), 15 U.S.C. §§ 77k and 77l(2) which in effect proscribe negligent misstatements in the sale of securities. *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (2d Cir. 1951).

The question therefore comes down to whether actual knowledge of the misstatement alone is sufficient or whether, in addition, this knowledge must be coupled with intent to defraud. Support for the view that intent to defraud is unnecessary can be gleaned from the legislation itself. First, the action of deceit and its requisites have deep roots in the common law, see, e.g., *Pasley* v. *Freeman*, 3 Term Rep. 51, 100 Eng. Rep. 450 (1789); Prosser, Torts 669-700 (3d ed. 1964), it seems reasonable, in light of this history, to infer that if Congress had desired to use an "intent to defraud" concept in these sections of the securities acts, it merely had to refer to time-honored classic phrases which

were quite familiar, see The Mail Fraud Statute, 18 U.S.C. §.1341. Instead, words referring primarily to conduct, but implying premeditation with a view to gain at the expense of others, were employed, such as "manipulative . . . device" or "contrivance." Second, the criminal penalties visited upon one who files a false and misleading statement only require wilfulness and intentional conduct, but do not require an intent to defraud, 15 U.S.C. §§ 77yyy, 78ff. To impose upon the civil plaintiff the burden of demonstrating intent to defraud when no such burden is imposed upon the Government in a related criminal case arising out of the same statement or document would create an anomolous result. Since the statutes in question, §§ 17(a) and 10(b), do not force one to this rather odd conclusion, they should not be so read. See III Loss, Securities Regulation 1442 n. 45, 1766 (1961 ed.). Therefore the Court rejects defendants' contentions that intent to defraud is an essential element of a private cause of action under §§ 17(a), 10(b) and Rule 10b-5.

Defendants also contend that there is an absence of evidence to demonstrate that plaintiffs' economic loss was caused by reason of the false and misleading Offering Circular. They contend that the drop in prices following disclosure of the dispute on April 21, 1965 may have been attributable to factors unrelated to misrepresentations in the Offering Circular. However, the parties, in response to an inquiry by the Court, agreed, assuming liability was established, that the damages suffered by plaintiffs by reason of the Offering Circular wuold be the difference between the purchase price less the sale price, subject to a duty on the part of each plaintiff to mitigate (Charge p. 42). As a result, defendants are estopped from now contending that the damages caused by reason of the false and misleading Offering Circular are different from the amounts so stipulated. Moreover, in view of Law Research's price movements coupled with the dates of the disclosure of the

material information omitted from the Offering Circular, there was ample evidence to support the inference that the drop in the stock prices was brought about by revelation of the dispute. Certainly when viewed in the light of the materiality of the Sperry Rand contract to Law Research these damages were foreseeable and within the contemplation of the defendants.

Turning to the cross-claim by Blair & Co. against the other defendants and Wiener, Blair's claim against Law Research is founded on paragraph 9 of the underwriting agreement which obligated Law Research to indemnify Blair & Co. for any loss arising out of any untrue statement of a material fact in the Offering Circular, except that Blair was not to obtain indemnification by reason of any willful misfeasence, bad faith or gross negligence in the performance of its duties or by reason of its reckless disregard of its obligations and duties under the agreement. The theory supporting recovery against Hoppenfeld and Wiener is that they were "active" wrongdoers who represented to Blair & Co. that the statements contained in the Offering Circular were not false and misleading, while Blair & Co. was merely a "passive" tortfeasor. Upon presenting the cross-claim to the jury, Blair & Co.'s counsel argued that even though it had been found liable by the jury, it was entitled to indemnity from Law Research Service, Inc. for the reason that it, Hoppenfeld and Wiener were the primary wrongdoers and more guilty than Blair itself. Of this there could be no doubt, since Hoppenfeld knew far more of the details involved than Blair and stood to gain more than Blair if the issue was successfully marketed. On the other hand, Blair also was advised by him of certain of the material facts omittend, even though it was not advised of all of them.

Apparently the jury concluded that as between the wrongdoers Blair & Co. was less guilty than the others and therefore should be able to collect over from them.

Decision of the United States District Court for the Southern District of New York

After reviewing the matter this Court believes that it would be against the public policy embodied in the federal securities legislation to permit Blair & Co., which has been found guilty of misconduct in violation of the public interest involving actual knowledge of false and misleading statements or omissions and wanton indifference to its obligations and the rights of others, to enforce its indemnification agreement. The purpose of the federal securities acts is to insure that the public investor, including particularly small investors such as the plaintiffs here, will obtain the benefit of a thorough investigation of the facts set forth in a prospectus or offering circular, not only by the issuer but also by the underwriter, so that prospective investors will have access to the truth. If an underwriter were to be permitted to escape liability for its own misconduct by obtaining indemnity from the issuers, it would have less of an incentive to conduct a thorough investigation and to be truthful in the prospectus distributed under its name, than it would be if the indemnity was unenforceable under such circumstances.

It is no answer that the indemnity agreement will not prevent the plaintiff-investor from being made whole, since he may collect against both the issuer and the underwriter. Many defrauded investors fail to sue either because they are unaware of a misrepresentation or lack the funds to finance such expensive litigation. Since §§11 and 12(2) of the 1933 Act, 15 U.S.C. §§77k, 771(2), require a diligent investigation by the underwriter, its motivation to conduct such an investigation, and to insure that the circular will be truthful, should not be lessened by permitting enforcement of the indemnity agreement, at least under circumstances where he has been found guilty of misconduct evincing actual knowledge or reckless disregard of the falsity of the offering circular, see III Loss, Securities Regulation 1831; Note, Indemnification of Underwriters and Section 11 of the Securities Act of 1933, 72 Yale L. J.

406, 409-12; compare *Chabot* v. *Empire Trust Co.*, 301 F.2d 458 (2d Cir. 1962). Substantially similar reasoning supports dismissal of Blair & Co.'s claims based upon the active misconduct of Law Research, Hoppenfeld, and Wiener in contradistinction to its own more passive misconduct.

Defendant Blair & Co. further contends that since the jury found it to have violated §17(a) of the Securities Act of 1933, and §§10(b) and 15(c) of the Securities Exchange Act of 1934, and assessed punitive damages against it, while finding in its favor on its cross-claim against Law Research, inconsistent verdicts are posed. It seeks to have all verdicts set aside and a new trial ordered.

This is not a case in which written interrogatories were submitted to the jury, so that Rule 49(b), F.R.C.P., is inapplicable. In this case the jury appears to have been led by Blair's argument—that the defendants Law Research and Hoppenfeld and third party defendant Wiener bore the primary responsibility—into thinking that their duty was to weigh the respective moral fault of each of the parties. This, however, was not true with respect to the indemnity agreement in favor of Blair as against Law Research. Under these circumstances, the Court is not disposed to grant Blair's motion. Moreover, as was recently said by the learned and able Judge Weinfeld:

> "Inconsistent jury verdicts upon different counts or claims are not an anomoly in the law, which at times recognizes a jury's right to an idiosyncratic position, provided the challenged verdict is based upon the evidence and the law." *Malm* v. *United States Lines Co.*, 269 F. Supp. 731-32 (S.D.N.Y.), *aff'd. per curiam*, 378 F.2d 941 (2d Cir. 1967). Accord *Sylvestri* v. *Warner & Swasey Co.*, Dkt. Nos. 32022, 32023, at 2786-87, — F.2d —, — (2d Cir. 1968).

Furthermore, dismissal of Blair's cross-claims against Law Research and Hoppenfeld and its impleader action against Wiener removes any inconsistency that even arguably was in existence.

For the foregoing reasons the motion to dismiss Blair & Co.'s cross-claim and third party claim and for judgment notwithstanding the verdict with respect to such claims is granted. All other motions are denied.

So Ordered.

Walter R. Mansfield.
U.S.D.J.

Dated: July 2, 1968.

Appendix

"Punitive damages are intended to penalize or to punish a defendant for certain kinds of conduct deemed to be against public interest, which involve a high degree of moral culpability.

. . . . .

"In addition to damages compensating a plaintiff for his injuries, you may, but you are not required to, allow a plaintiff punitive damages against any defendants causing the injury complained of if you find that the acts of any such defendants were the result of gross fraud and deceit that was aimed at the public generally and involved a high degree of moral culpability.

"There is no exact rule by which to determine the amount of punitive damages. If you find that the defendants' acts were grossly fraudulent, and aimed at the public generally and involved a high degree of moral culpability, you may fix such amount as in the exercise of your sound discretion and judgment you find will serve to punish the defendant or defendants involved and deter others from commission of like offenses.

"In awarding punitive damages, if you should decide to award them, you are also entitled to fix counsel fees and include such fees in the punitive damages figure that you reach."

Opinion of the United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 583-85—September Term, 1968.

(Argued May 15, 1969 Decided September 8, 1969.)

Docket Nos. 32766-68

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,
Plaintiffs-Appellees,

v.

LAW RESEARCH SERVICE, INC. and ELLIAS C. HOPPENFELD,
Defendants-Appellants,

and

BLAIR & CO., GRANBERY MARACHE INCORPORATED,
Defendant-Appellant and Third-Party Plaintiff-Appellant,

v.

PAUL WIENER,
Third-Party Defendant-Appellee.

Before:

WATERMAN, SMITH and KAUFMAN, *Circuit Judges.*

Appeal from a judgment by the District Court for the Southern District of New York, MANSFIELD, *J.*, awarding

punitive and compensatory damages for violation of the Securities Act and the Securities Exchange Act and denying an underwriter indemnity against the issuer of the securities in question. Reversed as to punitive damages and otherwise affirmed.

HAROLD L. YOUNG, New York, N. Y. (Cooper, Ostrin, DeVarco & Ackerman, Herman E. Cooper, Philip D. Tobin, on the brief), *for plaintiffs-appellees.*

ALFRED S. JULIEN, New York, N. Y. (Julien, Glaser & Blitz, Helen B. Stoller, on the brief), *for defendants-appellants and LRS and Hoppenfeld and third-party defendant-appellee, Wiener.*

DOUGLAS M. PARKER, New York, N. Y. (Mudge Rose Guthrie & Alexander, Goldthwaite H. Dorr, Robert P. Visser, on the brief), *for defendant-appellant and third-party plaintiff-appellant Blair & Co., Granbery Marache Inc.*

KAUFMAN, *Circuit Judge*:

This tortuous litigation raises at least two issues of great importance: are punitive damages available in private actions based on § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); and, may an underwriter be indemnified by an issuer for liabilities arising out of misstatements in an offering circular of which the underwriter had actual knowledge? We hold that punitive damages may not be recovered under § 17(a) and that an underwriter may not be indemnified in a case such as this.

Opinion of the United States Court of Appeals for the Second Circuit

The plaintiffs-appellees, purchasers of the stock of Law Research Services, Inc. (LRS), initiated this action against LRS, its president Ellias C. Hoppenfeld, and the underwriter of LRS's public stock offer, Blair & Co., Granbery Marache, Inc. (Blair). They contended that the appellants violated § 17(a) of the Securities Act of 1933, § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b),[1]

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[1] Section 17(a) of the Securities Act of 1933 reads:

> (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

And, Section 10(b) of the Securities Exchange Act of 1934 reads:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5, is virtually identical to 17(a) except that the statutory provision applies only to the conduct of sellers, while the rule governs the conduct of both buyers and sellers. See 3 Loss, Securities Regulation 1424-25 (1961).

and also committed common law fraud. The essence of their charge is that the offering circular prepared in connection with LRS's offer to sell 100,000 shares of its stock to the public under Regulation A of the Securities and Exchange Commission[2] was misleading since it prominently featured an attractive contract between LRS and the Sperry Rand Corp. (Sperry Rand) while failing to refer to a dispute between the two companies which had led Sperry Rand to terminate some of its services to LRS and in turn caused LRS to file suit against Sperry Rand. Moreover, the plaintiffs contended that Blair's actions violated § 12(2) of the 1933 Act, 15 U.S.C. § 771(2), and § 15(c) of the 1934 Act, 15 U.S.C. § 780-c[3]

Judge Mansfield presided over a ten-day trial of these claims, to a jury in the Southern District of New York. The jury returned a verdict in favor of Blair, LRS and Hoppenfeld on the common law fraud claim but also decided that all three had violated both the Securities Act of 1933 and the Securities Exchange Act of 1934. Accordingly, the jury awarded compensatory damages to all plaintiffs totaling $32,591.14 and punitive damages against Hoppenfeld in the amount of $26,812.06 and Blair in the amount of $13,000, based on the violation of § 17(a) of the 1933 Act.

The jury was also called upon to deal with a cross-claim asserted by Blair against LRS, which rested on an

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[2] Regulation A of the 1933 Act permits an issuer of stock to make a small public offering without filing the complex and lengthy registration statement and prospectus normally required by law. Nonetheless, the issuer must still submit to the SEC an offering circular containing basic information about the stock and its issuer. After review by the SEC the offering circular is distributed to prospective purchasers of the stock. See 17 C.F.R. §§ 230.251-62.

[3] Blair was also charged with a violation of § 12(1) of the 1933 Act, 15 U.S.C. § 77(1), but plaintiffs consented to the dismissal of this count.

indemnity clause included in the underwriting agreement, and against Hoppenfeld and a third-party defendant, Paul Wiener, Secretary-Treasurer of LRS, sounding in tort. At the same time, LRS and Hoppenfeld asserted a cross-claim against Blair, grounded on the same indemnity agreement. On all these cross-claims, the jury found for Blair.

Blair and Hoppenfeld then moved unsuccessfully to have Judge Mansfield set aside the award of punitive damages. LRS, Hoppenfeld and Weiner, however, moved successfully to set aside the verdict on the cross-claims for indemnity and the entry of judgment, pursuant to Fed. R. Civ. P. 50(b). Judge Mansfield's careful and thorough opinion of July 19, 1968 is reported at 287 F. Supp. 188. In sum therefore, LRS, Hoppenfeld and Blair appeal from the award of damages to appellees and Blair appeals from the Judgment on the cross-claims and third-party action.

I—Facts

Law Research Service is a child of the computer age. In 1960, Hoppenfeld, a lawyer with some background in computer technology, perceived that computers could greatly facilitate legal research. He concluded that a practical system could be developed in which thousands upon thousands of court opinions would be fed into a computer, so that when a legal problem was submitted to the machine it would then select and retrieve all the relevant precedents. For this service, lawyers would be required to pay an annual subscription and a small fee per inquiry. After mulling over the practicability of his conception for some time, Hoppenfeld organized LRS in 1963. He became its founder, president, legal advisor, director and sole stockholder. Wiener, Hoppenfeld's friend of many years, agreed to serve as Secretary-Treasurer of the corporation. Similar ideas for marrying computers to the law have been put forth, but it seems that LRS was the first such legal information retrieval system to be tried commercially.

Though Hoppenfeld was familiar with data systems, he recognized that greater expertise was called for if the new company was to become commercially successful. Moreover, he could not afford to purchase the expensive and sophisticated hardware necessary to bring his concept to fruition. Accordingly, on June 5, 1963, he entered into a five-year contract with the Univac [computer] division of the Sperry Rand Corporation. This agreement provided among other things that LRS was to furnish the legal data while Sperry Rand would supply such vital services as computer trial, programming, keypunching and printing. LRS also moved into the Sperry Rand building in New York City.

LRS's information retrieval system became operational in February 1964. By August of that year, the company managed to accumulate some $82,000 in debts to Sperry Rand. During that summer month, Hoppenfeld first met with Malcolm Sanders, a vice president of Blair, to explore ways of getting the $82,000, and other needed funds for the company. Sanders suggested a public offering which would raise not only enough money to cover the debt to Sperry Rand but would permit LRS to expand its computer library to cover decisions of the federal courts as well as those of the New York courts then already on tape.

On September 9, 1964, Sanders wrote Hoppenfeld that Blair was interested in raising $500,000 in new capital for LRS. He indicated that although bank financing or other loans might be arranged for part of the total, "we would raise the bulk of the money through the sale of equity." Accordingly, Sanders proposed that LRS retain a "nationally recognized firm of auditors who will set up principles of accounting which will be used by you in your presentation to investors." Hoppenfeld testified that Sanders introduced him to a partner in the accounting firm of Arthur Young & Co. (Young) and at Sanders' suggestion, LRS retained the firm to conduct the necessary audit. Arthur

Young & Co. served as accountants for both Blair and Blair's counsel, then Nixon, Mudge, Rose, Guthrie, Alexander & Mitchell [now Mudge, Rose, Guthrie & Alexander and hereinafter Nixon Mudge], which firm subsequently played a role in the preparation of the offering circular. Thereafter, Frederick B. Johnston, an associate of Arthur Young & Co., spent two or three days a week and occasional weekends between November 1964 and March 1965 at the LRS office, examining all of its books, records and legal files.

During this time, however, dissension had arisen between Sperry Rand and LRS and in October 1964, Hoppenfeld informed both Johnston of Young and Co., and Sanders of Blair, that LRS had served a summons on Sperry Rand in an action based on the debt LRS allegedly owed the computer corporation and the adequacy of the office space allotted to LRS. LRS opted to let this action lapse in December 1964 by not filing a complaint. Hoppenfeld testified he permitted this so that he could continue negotiations with Sperry Rand, whose vice president for legal services, Robert C. Sullivan, refused even to discuss the dispute or anything else with Hoppenfeld while the summons was outstanding.

On January 25, 1965, the crisis began. J. E. Murdock, New York regional manager of Sperry Rand's Univac division, informed LRS by letter that unless it paid $82,897 by Friday, January 29, 1965, Sperry Rand would consider the contract "terminated." Hoppenfeld immediately proceeded to the Sperry Rand office in the same building to discuss the matter with Sullivan, whom the LRS president considered to be Murdock's superior.[4] After Hoppenfeld

[4] Hence Hoppenfeld testified that he believed Murdock could not effectively revoke the contract without Sullivan's consent. Sullivan testified at trial, however, that the letter had been sent with his knowledge and consent.

informed Sullivan that the financing was taking longer than expected and that Sperry Rand would be paid out of the proceeds of the public offering, Hoppenfeld testified that Sullivan replied that Sperry Rand's sole interest was getting paid and that if this was achieved all would be well.

Nevertheless, on January 29, Sperry Rand refused to permit LRS to use its computers for processing inquiries for LRS subscribers. It did, however, continue to provide keypunching and other services.[5] On the same day, LRS initiated a suit against Sperry Rand. This new litigation was, like its predecessor, instituted by the service of a summons without a complaint. An affidavit by Wiener submitted with the summons indicated that the cause of action was based on breach of contract and fraud.

These two events of January 29, Sperry Rand's termination of computer services and LRS's lawsuit, are the material facts which the appellees claim were omitted from the offering circular.

Blair and LRS are in complete disagreement as to whether Hoppenfeld informed its underwriter of these events. Hoppenfeld explicitly testified that he told Sanders during February 1965 that Sperry Rand had refused LRS the use of its computers. Moreover, Hoppenfeld and Johnston held a "bare diligence" meeting on February 23 to review any new developments which might affect the issue of the stock. At that time, Hoppenfeld insists, he divulged to Johnston the recent legal activity. Hoppenfeld also claimed that Johnston appeared on February 23 as the representative of both Arthur Young & Co. and Blair.

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[5] Since the LRS tapes could be used on any Univac III computer, several of which were accessible in the New York area, Hoppenfeld testified that he did not believe Sperry Rand's action detrimentally affected the future of LRS. However, many plaintiffs indicated that what impressed them in the offering circular was not merely the use of Univac computers but the prestige of Sperry Rand's name.

Despite all this, the plans for the public offering proceeded and ultimately became effective on March 15, 1965. It authorized the issuance of 500,000 shares of which 100,000 would be offered to the public, at $3 per share. All the stock was sold in a few days, resulting in net proceeds to LRS of $260,000.[6] Hoppenfeld retained 200,000 shares for himself. The offering circular, which accompanied every sale of the stock, referred in bold face type to the Sperry Rand contract and described the agreement in detail. It went on to note:

> "The Company at December 31, 1964 was indebted to the Sperry Rand Corporation in the amount of $82,285 for key punching and other services. . . . The Company hopes, but has no commitment, that payment of part of this indebtedness can be deferred. The Company intends to repay this amount . . . from the proceeds of the sale of the Common Stock offered hereby. . . ."

The offering circular failed to mention or even suggest the events of January 29 or the dispute between LRS and its "supplier" had occurred.

Hoppenfeld sought to explain this startling omission by urging that, although he was a lawyer of long experience and was listed in the offering circular as the person who passed on legal matters in connection with the offering for LRS, he relied on the advice of Blair, Young and Nixon Madge. He recalled they told him that only lawsuits pending against LRS would have to be reported and hence he

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[6] LRS also borrowed $125,000 at 6% from the Franklin National Bank and sold $125,000 in 8% debentures to the Franklin Corporation, a small business investment company connected with the bank. Thus the total raised was $510,000 of which $82,285 was earmarked for the Sperry Rand debt. Most of the remainder was to be devoted to indexing the decisions of the federal courts, a project which would cost $445,000.

did not mention the suit brought by LRS. Blair on the other hand contended that it first became aware of the LRS suit on April 7 when a representative of the SEC telephoned William Bailey, the attorney at Nixon Mudge who had supervised the preparation of the LRS offering circular. The SEC wanted to know if Bailey was aware of LRS's legal actions against Sperry Rand.

In either event, a series of hastily called meetings were held after April 7 and, on April 21, Sperry Rand was paid in full and the LRS suit was dismissed with prejudice. The next day a "report from the President" was mailed to all LRS shareholders describing, in rather vague terms, the entire affair.[7]

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[7] The letter reads as follows:

LAW RESEARCH SERVICE, INC.
1290 Avenue of the Americas
New York, New York

REPORT FROM THE PRESIDENT

Negotiations with Sperry Rand Corporation have been consummated resulting in amendments to this Company's contract with Sperry Rand, which continues to run for five years from June 5, 1963, and was the subject of certain differences including the assertion by Sperry Rand that it had been terminated. These differences antedated the recent Offering Circular of this Company and were not referred to therein. Among the amendments to the contract is a provision for deposits of $10,000 by this Company with Sperry Rand for new programming or other services to be rendered by them, and a provision for termination of the contract by Sperry Rand, upon 30 days notice, for default. In connection with the negotiations this Company's lawsuit against Sperry Rand has been discontinued.

Herman E. Goodman, President of The Franklin Corporation, and Malcolm D. Sanders, a Vice President of Blair & Co., Granbery, Marache Incorporated, have been elected directors of Law Research Service, Inc. which now has a four-man Board.

April 22, 1965

signed/ ELLIAS C. HOPPENFELD
ELLIAS C. HOPPENFELD
President

Opinion of the United States Court of Appeals for the Second Circuit

Morton Globus, apparently the prime mover in initiating the action before us, is a broker-dealer in securities. He became aware of the proposed LRS offering shortly before March 15 by reading a small item in the Commercial and Financial Chronicle. Globus found the concept of utilizing computers in legal matters exciting and on March 12, 1965, he wrote Blair for copies of the offering circular. These he then sent to some of his customers. But, before mailing, Globus personally underlined significant sections of the offering circular including the paragraphs dealing with the Sperry Rand contract. The other plaintiffs are small investors and customers of Globus who purchased LRS between March 16 and April 20, 1965. The thirteen appellees purchased 23% of all the LRS stock offered to the public.

Mr. Globus bought 4,400 shares for himself at prices ranging between 4 and 4⅝. He sold them on September 13, 1965 at 2¾ for a loss of $7,561. He admitted that he sold the stock with the intention of taking a loss for tax purposes and hoped to repurchase LRS later. On October 27, 1965 he bought back 4,000 shares which he later resold at a considerable profit. The other appellees, however, asserted that they did not intend to repurchase LRS when they sold their shares. They stated that they relied on the offering circular in deciding to buy LRS and were specifically impressed by the mention of the Sperry Rand contract. It appears to us therefore, that there was adequate evidence from which the jury might conclude that the dispute and lawsuit between LRS and Sperry Rand was a material fact the omission of which from the offering circular caused the circular to be misleading. Also there was ample evidence, albeit based largely on Hoppenfeld's testimony, to support the conclusion that Blair had knowledge of that important dispute.

II—Punitive Damages

Judge Mansfield charged the jury that punitive damages could be awarded against the appellants if it found their conduct involved "a high degree of moral culpability of a type that would in effect constitute moral turpitude or dishonesty and a wanton indifference to one's obligations." 287 F. Supp. at 193. This standard of "high moral culpability" was drawn from a New York case permitting punitive damages in fraud actions. *Walker* v. *Sheldon*, 10 N.Y. 2d 401, 405, 223 N.Y.S. 2d 488, 179 N.E. 2d 497 (1961).

Punitive, or exemplary damages, as they are sometimes called, are not available for violations of § 10(b) of the 1934 Act. *Green* v. *Wolf Corp.*, 406 F. 2d 291 (2d Cir. 1968), cert. denied — U.S. —; *Meisel* v. *North Jersey Trust Co. of Ridgewood, N.J.*, 216 F. Supp. 469 (S.D.N.Y. 1963). But the district court instructed the jury that this did not inhibit it from making an award of such damages under § 17(a) of the 1933 Act. Accordingly, the jury awarded punitive damages against Hoppenfeld and Blair, although no such damages were assessed against LRS itself. This appears to be the first occasion on which punitive damages have actually been awarded for a violation of the securities acts. But cf. *Nagel* v. *Prescott & Co.*, 36 F.R.D. 445 (N.D. Ohio 1964) (denying motion to strike interrogatories on ground that punitive damages are available under the 1933 Act).

Section 17(a) on its face simply makes it unlawful for sellers of securities to engage in fraudulent transactions or to omit to state material facts. As with other provisions of the securities acts, several courts have indicated that a private right of action will lie for the violation of the provisions of this section. See *Dack* v. *Shanahan*, 227 F. Supp. 26 (S.D.N.Y. 1964); *Thiele* v. *Shields*, 131 F. Supp. 416 (S.D.N.Y. 1955); Note, Implying Causes of Actions from Federal Statutes, 77 Harv. L. Rev. 285 (1963).

See also *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783, 787 n. 2 (1951); *Katz* v. *Amos Treat & Co.*, Docket Nos. 32408, 32471, 32481-82 (2d Cir. May 16, 1969). But even today there lingers some unhappiness with this principle. See 6 Loss, Securities Regulation 3912 (1969). Since we affirm only the award of compensatory damages, which could stand either on the basis of § 10(b) of the 1934 Act or § 17(a), we need not tarry over whether § 17(a) standing alone would support an action for compensatory damages. My brother Friendly pointed out in his concurring opinion in *SEC* v. *Texas Gulf Sulphur*, 401 F. 2d 833, 867 (1968), cert. denied, — U.S. —, that there seems little practical point in denying the existence of an action under § 17 once it is established that an aggrieved buyer has a private action under § 10(b) of the 1934 Act. But we still must determine whether § 17(a) will suffice as a basis for punitive damages.

The issue is complicated by the presence of a conflicting gaggle of "general rules." Although some courts have not hesitated to include recovery of exemplary damages when upholding the right to bring an action implied by the provisions of a specific statute, e.g., *Batista* v. *Weir*, 340 F. 2d 74, 84-88 (3d Cir. 1965); *Wills* v. *Trans American Airlines*, 200 F. Supp. 360 (S.D. Cal. 1961), other courts have stated that "absent express Congressional intention punitive damages [are] not recoverable when invoking the jurisdiction of the court on a federally created cause of action." *Burris* v. *Teamsters Union*, 224 F. Supp. 277, 280 (W.D.N.C. 1963); *United Mine Workers* v. *Patton*, 211 F. 2d 742, 749 (4th Cir.), cert. denied, 348 U.S. 824 (1954) ("when Congress has intended that damages in excess of the actual damage sustained by the plaintiff may be recovered in an action created by statute, it has found no difficulty in using language appropriate to that end"); *Green* v. *Wolf Corp.*, *supra*, at 303 ("[w]e have gone far beyond the limits of the common law in imposing liability under 10b-5 [of the 1934 Act] and thus may not import

all the other aspects of common law fraud without scrutiny").

We need not opt for either of these conflicting generalities; rather, we rely on an analysis of the role punitive damages would play in the statutory scheme established for the enforcement of the Securities Act. In 1933, when this scheme was formulated, the prevailing opinion among knowledgeable commentators and members of the Securities and Exchange Commission was that civil liability would be limited to the express liability provisions of §§ 11 and 12 of the Act; 17(a) would serve as a basis only for criminal or injunctive action. See Landis, The Liability Sections of the Securities Act, 18 Am. Accountant 330, 331 (1931), quoted in 3 Loss, *supra*, 1784-85 (1961); Douglas & Bates, The Federal Securities Act of 1933, 43 Yale L.J. 171, 181-82 (1933); Note, Federal Regulation of Securities: Some Problems of Civil Liability, 48 Harv. L. Rev. 107 (1934). See also 54 Va. L. Rev. 1560, 1566 (1968). Those sections of the Act which provide expressly for civil liability retrict themselves to compensatory damages. 15 U.S.C. §§ 77k(e), 77l(2). See *Shonts* v. *Hirliman*, 281 F. Supp. 478, 482 (S. D. Cal. 1939). Since even in this day of easily implied liability under the securities acts, it is not settled to everyone's satisfaction that compensatory damages are authorized by 17(a), it would no doubt jolt and startle the draftsmen of the 1933 Act to be told that they also authorized the recovery of punitive damages when that section was formulated.

But neither Congressional mindreading nor stenciling the bounds of the express liability sections onto § 17(a) provide a firm basis for decision. Since it is more difficult to prove a violation of 17(a) than the express liability provisions of the 1933 Act, see *Thiele* v. *Shields, supra*, a court implying a remedy under 17 is not necessarily bound by the restraints of the express liability sections. For example, civil actions under 17(a) are not subject to the same time limitations as are suits under the latter provi-

sions. *Katz* v. *Amos Treat & Co., supra,* slipsheet at 2183 n. 10; *Turner* v. *Lundquist,* 377 F. 2d 44 (9th Cir. 1967); *Charney* v. *Thomas,* 372 F. 2d 97 (6th Cir. 1967).

The seminal question is whether punitive damage recovery is necessary for the effective enforcement of the Act. Undeniably, punitive damages would deter violations of the Act and punish those who did commit violations. Cf. *Green* v. *Wolf Corp., supra*; Restatement, Torts § 908, Comment a. See generally Note, Exemplary Damages in the Law of Torts, 70 Harv. L. Rev. 517 (1957); Note, The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages, 41 N.Y.U. L. Rev. 1159 (1966). But, as the trial court conceded, see 287 F. Supp. at 194, plaintiffs under the securities acts already possess an extensive "arsenal of weapons" which serve to perform the functions of retribution and deterrence.

The 1933 Act provides not only for a fine but five years imprisonment for those who violate 17(a). 15 U.S.C. § 77x. Moreover, the SEC may suspend or expel those who violate the securities acts or suspend trading in a particular stock. Furthermore, private actions often lead to sizable recoveries and to considerable deterrent clout. In *Green* v. *Wolf Corp., supra,* we recognized that a class action under Fed. R. Civ. P. 23 could be particularly effective and appropriate in remedying violations of the securities acts when the injury to any individual was not large enough to provoke him to legal action. Thus a recurring rationale for punitive damages—that the lure of a windfall is required to encourage suits to enforce the Act—has lesser impact where the class action for the small litigant would be appropriate.[8] Compensatory damages, especially when multi-

[8] The present suit was initiated as a class action. However, on May 2, 1967, Judge Frankel determined that the action could not be maintained as a class action. The record before us does not indicate the reasons for Judge Frankel's decision. Nor have plaintiffs appealed from this order. Opinions subsequent to his decisions have broadened the scope of class actions under Fed. R. Civ. P. 23. *Green* v. *Wolf Corp., supra*; *Eisen* v. *Carlisle & Jacquelin,* 391 F. 2d 555 (2d Cir. 1968).

plied in a class action, have a potent deterrent effect. And there always lurks the psychological deterrent of being branded a knowing violator of the law. This is particularly true in an industry where, as the sages put it, a good name is worth more than a crown. Cf. *Stevens* v. *Abbott, Proctor & Paine*, 288 F. Supp. 836 (E.D. Va. 1968).

Against any marginal deterrent effect which may result from adding the weapon of punitive damages to this already well-stocked arsenal, we must weigh the potentially awesome injuries that such damages may impose. A violation of 17(a) is not often limited to a single purchaser. Rather, a misstatement in the prospectus or offering circular will harm nearly all those who read it. If all are permitted to recover not only compensatory damages but "smart money" as well the sum of the liabilities could well bankrupt an otherwise honest underwriter or issuer who egregiously erred in one instance which affected many.

In *Roginsky* v. *Richardson-Merrell Inc.*, 378 F. 2d 832 (2d Cir. 1967) this court denied punitive damages in an action charging a drug manufacturer with irresponsibility in marketing a drug which injured hundreds of people. The opinion emphasized that punitive damages are normally awarded in situations where there is only a single injured party and thus the total amount of punitive damages may be kept to a reasonable level. A single misstatement or omission in a prospectus or offering circular, although less dangerous than a drug, may leave those responsible liable to literally thousands of purchasers.[9]

Nor does there appear to be any way for us to fairly restrict the punitive award. It may not always be possible to circumscribe all possible plaintiffs in a single suit. Nor can we predict how many suits will arise from any par-

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[9] See *Green* v. *Wolf*, *supra*, 406 F. 2d at 303, n. 18; e.g., *Curtis Pub. Co.* v. *Butts*, 388 U.S. 130 (1957) ($3 million in punitive damages reduced by the court to $460,000).

ticular violation. And, as *Roginsky* points out, "We know of no principle whereby the first punitive award exhausts all claims for punitive damages and would thus preclude future judgments." 378 F. 2d at 839. Even if such a principle were valid we would have some doubt about the propriety of providing a windfall to the first litigant to chance upon a sympathetic jury.[10]

Finally, to permit punitive damages under the 1933 Act would create an unfortunate dichotomy between the 1933 and 1934 Acts. Section 28(a) of the 1934 Act prohibits punitive damages in actions brought under that Act.[11] But the 1934 Act is the only basis upon which defrauded sellers of securities could obtain relief, see *Royal Air Properties* v. *Smith*, 312 F. 2d 210 (9th Cir. 1962); 17(a) of the 1933 Act by its terms only provides protection to purchasers of stock

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[10] It is true that in the instant case, the jury was quite moderate in its award of punitive damages, and specifically refrained from awarding punitive damages against LRS, in which case the damages would really have fallen in part on innocent stockholders. Nonetheless, the danger of overkill would clearly be present in future actions under § 17(a). The interests of justice are clearly served by announcing the rule we consider appropriate for all cases under this section.

[11] Blair and Hoppenfeld argue that § 28(a) also prohibits punitive damages regardless of the theory on which they are based in any suit in which a claim for damages under the 1934 Act is made. They rely on that sentence in § 28(a) which reads "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages. . . ." Cf. *Pappas* v. *Moss*, 257 F. Supp. 345, 364 (D.N.J. 1968), rev'd on other grounds, 393 F. 2d 865 (3d Cir. 1968). We need not reach this question since we have found that § 17(a) of the 1933 Act does not support punitive damages for several reasons. Because the jury found the defendants not liable on the common law fraud count, we also do not reach the question whether § 28(a) would prohibit punitive damages in an action for common law fraud joined to an action based on the 1934 Act.

who are damaged by fraud. Allowing exemplary damages under the 1933 but not under the 1934 Act would create an unreasoned split between buyers and sellers of securities subjected to fraud of an equally heinous nature.

To avoid such inconsistencies, courts have endeavored to treat the '33 and '34 Acts *in pari materia* and to construe them as a single comprehensive scheme of regulation. *United States* v. *Morgan*, 118 F. Supp. 621, 691 (S.D.N.Y. 1953); *Brown* v. *Gilligan Will & Co.*, 287 F. Supp. 766, 775 (S.D.N.Y. 1968); *Rosenberg* v. *Globe Aircraft Corp.*, 80 F. Supp. 123 (E.D. Pa. 1948); *Lennerth* v. *Mendenhall*, 234 F. Supp. 59, 62 (N.D. Ohio 1964). Professor Loss has written that the two statutes are "as closely related as two nominally separate statutes could be." 6 Loss, Securities Regulation 3915 (1969). Moreover, Sections 15(b)(5)-(7) and 15A(1)-(2) of the 1934 Act make a broker-dealer's wilful violation of *either* act a ground for various administrative sanctions. And *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 357 (1963) instructs "the proper approach . . . is an analysis which reconciles the operation of both statutory schemes with another rather than holding one completely ousted."[12] While we need not consider whether this close relationship affects other provisions of the two acts, it is undesirable and unnecessary to insert a

[12] Our opinion in *Green* v. *Wolf Corp.*, *supra*, does contain some language indicating such a dichotomy does exist and that punitive damages may be permissible under the 1933 Act. 406 F. 2d at 303. However it is obvious to the careful reader that this was merely dicta intended to limit the holding in *Green* to the specific issue then before the court, i.e. the validity of punitive damages in an action based on § 10(b) and Rule 10b-5 of the 1934 Act and not as approval for the award of punitive damages under the 1933 Act. As we have demonstrated, *supra*, the reasoning of *Green* is completely consistent with our holding here. As to the legislative history on which Judge Mansfield purported to base the discrepancy between the two acts, see 54 Va. L. Rev. 1560 (1968).

wedge between innocent buyers and innocent sellers solely to provide yet another gram of deterrence.[13]

III—Indemnity

Judge Mansfield also granted the motion of LRS and Hoppenfeld to set aside the jury's verdict on the cross-claims granting indemnification to Blair. He thus struck down the indemnity agreement between the issuer and the underwriter, at least as it applied to the facts before us. Blair's cross-claim against LRS was based on a provision which compelled LRS to indemnify the underwriter for any loss arising out of an untrue statement of a material fact in the offering circular, except that Blair was not to obtain indemnification by reason of any wilful misfeasance, bad faith or gross negligence in the performance of its duties or by reason of its reckless disregard of its obligations under the agreement.[14] Its claim against Hoppen-

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[13] Because we conclude § 17(a) of the 1933 Act will not sustain an award of punitive damages, we also avoid the need to decide which law of punitive damages applies—state or federal common law or perhaps federal law incorporating state law. This conundrum has vexed the commentators. Compare 82 Harv. L. Rev. at 956 with 44 N.Y.U. L. Rev. at 234. If for example state law applied and some states permitted recovery of punitive damages while others did not, it would result in "varied protection for the same federal right." 82 Harv. L. Rev. at 956.

[14] The text of the indemnity clause reads:

Indemnification. (a) The Company will indemnify and hold you harmless and each person, if any, who controls you within the meaning of the Securities Act, against any losses, claims, damages or liabilities, joint or several, to which you, or any such controlling person, may become subject under the Securities Act or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in the Notification, the Offering Circular, or any amendment or supplement

feld and Wiener, who did not sign the indemnification agreement in their personal capacities rests on the theory that they were "active" wrongdoers while Blair was merely a "passive" joint tortfeasor.

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thereto, or arise out of or are based upon the omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading; and will reimburse you and each such controlling person for any legal or other expenses reasonably incurred by you or such controlling person in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the Company will not be liable in any such case to the extent that any such loss, claim, damage or liability arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission made in the Notification or the Offering Circular or such amendment or such supplement, in reliance upon and in conformity with written information furnished to the Company by you specifically for use in the preparation thereof and provided, further, that neither this indemnity agreement nor any of the representations or other warranties of the Company contained herein, to the extent that such agreement or any such representation or warranty rquires the Company to indemnify and hold harmless against liabilities arising under the Securities Act any controlling person of or any director, officer or partner of Blair & Co., Granbery, Marache Incorporated who, when the Notification becomes effective, is also a director of the Company, or whose election as a director of the Company upon completion of the current offering is anticipated at the time the Notification becomes effective, shall inure to the benefit of any such controlling person, director, officer or partner unless a court of competent jurisdiction shall have determined that such indemnification is not against public policy as expressed in the Securities Act. The Company shall not be required to indemnify you or any such controlling person for any payment made to any claimant in settlement of any suit or claim unless such payment is approved by the Company or by a court having jurisdiction of the controversy. Anything to the contrary in this Agreement notwithstanding, nothing herein shall protect or purport to protect you against any liability to the Company or its security holders to which you would otherwise be subject by reason of willful misfeasance, bad faith, or gross negligence in the performance of your duties or by reason of your reckless disregard of your obligations and duties under this Agreement. This indemnity agreement will be in addition to any liability which the Company may otherwise have.

The jury, by awarding compensatory and punitive damages to the plaintiffs under sections 17(a) and 10(b), necessarily found in light of the judge's charge, that Blair had actual knowledge of the material misstatements.[15] Cf. *Fischman* v. *Raytheon Mfg. Co., supra; Thiele* v. *Shields, supra.* Accordingly the court had ample basis to find Blair not deserving of recovery under the indemnity agreement itself. See 44 N.Y.U. L. Rev. 226, 227 (1969). But it chose instead the broader ground that where there is actual knowledge of the misstatement by the underwriter and wanton indifference by Blair to its obligations, "it would be against the public policy embodied in the federal securities legislation to permit Blair and Co. . . . to enforce its indemnification agreement." 287 F. Supp. at 199. Thus it is important to emphasize at the outset that at this time we consider only the case where the underwriter has committed a sin graver than ordinary negligence.

Given this state of the record, we concur in Judge Mansfield's ruling that to tolerate indemnity under these circumstances would encourage flaunting the policy of the common law and the Securities Act. It is well established that one cannot insure himself against his own reckless, wilful or criminal misconduct. See *Kansas City Operating Co.* v. *Durwood,* 278 F. 2d 354 (8th Cir. 1960); *cf. Holman* v. *Johnson,* 1 *Cowper,* 341, 343, 98 Eng. Rep. 1120, 1121; Prosser, Torts, § 48 (3d ed. 1964). See also 6 Loss at 3980.

Although the 1933 Act does not deal expressly with the question before us provisions in that Act confirm our conclusion that Blair should not be entitled to indemnity from LRS. See generally Note, Indemnification of Underwriters and § 11 of the Securities Act of 1933, 72 Yale L. J. 406. For example, § 11 of the Act, 15 U.S.C. 77k, makes underwriters jointly liable with directors, experts and signers

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[15] The matter of a possible inconsistency between the verdict finding Blair liable to appellees and the verdict awarding Blair indemnity is considered *infra* at Part IV.

of the registration statement.[16] And, the SEC has announced its view that indemnification of directors, officers and controlling persons for liabilities arising under the 1933 Act is against the public policy of the Act. 17 C.F.R. § 230.460. If we follow the syllogism through to its conclusion, underwriters should be treated equally with controlling persons and hence prohibited from obtaining indemnity from the issuer. See 72 Yale, *supra*, at 411. But see 3 Loss *supra*, at 1834 (1961).

Civil liability under section 11 and similar provisions was designed not so much to compensate the defrauded purchaser as to promote enforcement of the Act and to deter negligence by providing a penalty for those who fail in their duties. And Congress intended to impose a "high standard of trusteeship" on underwriters. Kroll, *supra*, at 687. Thus, what Professor Loss terms the "*in terrorem* effect" of civil liability, 3 Loss *supra*, at 1831, might well be thwarted if underwriters were free to pass their liability on to the issuer. Underwriters who knew they could be indemnified simply by showing that the issuer was "more liable" than they (a process not too difficult when the issuer is inevitably closer to the facts) would have a tendency to be lax in their independent investigations. Cf. *N. Y. Central RR* v. *Lockwood*, 84 U.S. (17 Wall.) 357, 377-78 (1873). Cases upholding indemnity for negligence in other fields are not necessarily apposite. The goal in such cases is to compensate the injured party. But the Securities Act is more concerned with prevention than cure.

Finally, it has been suggested that indemnification of the underwriter by the issuer is particularly suspect. Although in form the underwriter is reimbursed by the issuer, the

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[16] § 11 applies to full registrations. LRS's issue was under Regulation A. Compare 44 N.Y.U. L. Rev. at 229 n. 34 with Kroll, Some Reflections on Indemnification Provisions & S.E.C. Liability Insurance in the Light of BarChris and Globus, 24 Bus. L. 685 (1969).

recovery ultimately comes out of the pockets of the issuer's stockholders. Many of these stockholders may be the very purchasers to whom the underwriter should have been initially liable. The 1933 Act prohibits agreements with purchasers which purport to exempt individuals from liability arising under the Act. 15 U.S.C. 77n; see 82 Harv. L. Rev. *supra,* at 958. The situation before us is at least reminiscent of the evil this section was designed to avoid. But see Note, Indemnification of Underwriters, *supra,* 72 Yale L. J. at 408.

To turn briefly to the question of the cross-claim against Hoppenfeld and the third party claim against Wiener, similar reasoning supports Judge Mansfield's decision to grant judgment n.o.v. Blair may have been less active than Hoppenfeld, but since it had actual knowledge of the omitted facts and failed to take corrective action, it would be incongruous to permit it to recover over. Compare *Burns* v. *Cunard SS Co.,* 404 F. 2d 60 (2d Cir. 1968) cert. denied — U.S. —.

Finally, there is no inconsistency between the policy prohibiting punitive damages and denying enforcement of indemnity agreements similar to the one here. The first avoids uncontrollable windfalls to a few plaintiffs and inconsistencies in the treatment of buyers and sellers. The latter policy ensures that an underwriter will not be able to increase the issuer's liability while totally avoiding any injury to himself. In both instances, the proper purpose of the Act is to encourage diligence, investigation and compliance with the requirements of the statute by exposing issuers and underwriters to the substantial hazard of liability for compensatory damages.

IV—The Jury Verdicts

Blair protests that the jury's verdict awarding damages because Blair acted with "moral turpitude or wanton dishonesty," 287 F. Supp. 194, is irreconcilable with the jury's

verdict on the indemnity claim, in which the jury found for Blair after being told by the Judge that the "underwriter could not recover if it was guilty of "willful misfeasance, bad faith or gross negligence." Accordingly Blair asks that new trials be granted on both issues. As a corollary, it contends that the jury verdict in the cross-claims bars the court from imputing to it anything more than ordinary negligence and thus the argument that indemnity is against public policy must fall.

Judge Mansfield rejected this construction of the jury verdicts and the accompanying demand for new trials. He reasoned that the jury was led by Blair's argument—that LRS and Hoppenfeld were the primary wrongdoers—into believing that its duty was to weigh the respective moral fault of each party. There was no need for a balancing of fault, the Judge held with respect to the indemnity claim. 287 F. Supp. at 199-200. The fact that the jury awarded considerably higher punitive damages against Hoppenfeld than against Blair supports Judge Mansfeld's awareness of the jury's fascination with proportioned guilt. The differences in the jury's verdict on punitive damages also illustrate that its view of the degree of inculpation of Blair, LRS and Hoppenfeld remained consistent throughout the trial of both the main claims and the cross-claims.

Blair's strategy in trying the case may have contributed to any confusion the jury may have experienced. The jury's consideration of the indemnity claim was deferred, quite appropriately, until it had considered and acted on the underlying question of violation by Blair and LRS of the securities acts. Judge Mansfield repeatedly cautioned the jury during the trial of this question that the cross-claims were not yet before it. It is of some interest that the Judge seemed to recognize that it might be wise to unburden the same jury from the difficult task of grappling with the cross-claims. As a result, after the first verdict

was returned, the court suggested to Blair's counsel, Douglas M. Parker, Esq., that the cross-claims might best be tried to a referee, because if liability existed on the cross-claims, the question of damages would have to be handled by a referee in any case. Parker considered the court's proposal but elected to try the indemnity claim to the jury.

Blair's counsel then pursued the strategy of urging the jury to recognize that its determination of the indemnity claim was to be wholly independent of its findings on the first verdict. Parker began his presentation to the jury by candidly stating, "I am, of course, disappointed in your decision . . . but now I ask you to turn to another and a different question, and that is the respective responsibility as between Blair and Company on the one hand and Law Research and Mr. Hoppenfeld and Mr. Wiener on the other hand." Later on, he remarked, "By your verdict today as I mentioned before, you indicated that you found that Blair did have a responsibility that it failed to meet in this case. While I may disagree with your judgment, I must of course accept it and nothing I'm saying now is arguing against that." In any event, viewed in the context in which it arose, the jury's verdict on indemnity is not necessarily inconsistent with the initial verdict on the issue of liability.[17]

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[17] It has been said again and again, in civil as well as criminal cases such as *Dunn* v. *United States,* 284 U.S. 390 (1932) that consistent jury verdicts are not, in themselves, necessary attributes of a valid judgment. "[I]f there be an inconsistency in the verdicts which might have justified a trial court in granting a new trial it may nonetheless stand on appeal even though inconsistent. That is the jury's prerogative." *Int'l Longshoremen's Local 8* v. *Hawaiian Pineapple Co.,* 226 F. 2d 875, 881 (9th Cir. 1955), cert. denied 351 U.S. 963 (1956). See also *Jayne* v. *Mason and Dixon Lines,* 124 F. 2d 317, 319 (2d Cir. 1941); *Malm* v. *United States Lines Co.,* 269 F. Supp. 731 (S.D.N.Y.), affd. per cur. 378 F. 2d 941 (2d Cir.

V—Intent to Defraud

The jury was told that before the appellants could be held liable to plaintiffs, it must conclude that appellants "knew the statement was misleading or knew of the existence of facts which, if disclosed, would have shown it to be misleading." The trial court thus shared the view often advanced in this circuit that some form of scienter greater than mere negligence was required in order to permit plaintiffs to recover damages in a private action under 17(a) or 10(b). Cf., e.g., *Barnes* v. *Osofsky*, 373 F. 2d 269, 272 (2d Cir. 1967). *Hanley* v. *SEC*, Docket Nos. 33178, 33233-34, 33269, 33276 (2d Cir. July 24, 1969). But the trial judge refused to direct the jury that it must find appellants intended to defraud appellees before it determined that there was a violation of either of those sections.

The necessity of some intent to defraud or scienter has been the subject of much debate. See, e.g., *SEC* v. *Van Horn*, 371 F. 2d 181, 185 (17th Cir. 1966); *Ellis* v. *Carter*, 291 F. 2d 270 (9th Cir. 1961); *Royal Air Properties Inc.* v. *Smith, supra; Fishman* v. *Raytheon Mfg. Co., supra; Weber* v. *C. M. P. Corp.*, 242 F. Supp. 321 (S.D.N.Y. 1965); Bromberg, Securities Law, §§ 2.6(1), 2.7(1); 6 Loss, *supra*, at 3552-53, 3883-88. But the trend is clearly away from enforcing a scienter requirement equal to the "intent to defraud" required for common law fraud. Before there may be a violation of the securities acts there need not be present all of the same elements essential to a common law fraud, see *SEC* v. *Great American Industries*, 407 F. 2d 453, 463, cert. denied, — U.S. — (my concurring opinion).

Judge Mansfield's charge clearly required a finding of scienter, albeit not using the magic words "intent to de-

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1967). Although Blair asserts that the cases cited by its opponents are not in point because the opinions attempted to reconcile the verdicts, it is difficult to distinguish the case at bar, in which the jury's attitude towards the defendants remained consistent throughout and, in addition, where any alleged confusion by the jury was aided and abetted by Blair.

fraud." In *Heit* v. *Weitzen*, 402 F. 2d 909, 914 (2d Cir. 1968) this court concluded that an allegation of actual knowledge of falsity is amply sufficient as a matter of pleading to state a claim upon which relief could be granted under 10b-5. See also *United States* v. *Benjamin*, 328 F. 2d 854, 862-63 (2d Cir.), cert. denied, 377 U.S. 953 (1954). In this case there was an accusation of actual knowledge; there was also sufficient evidence to sustain the jury's finding of knowledge and in addition, that the appellants were guilty of "high moral culpability." [18] Thus, whatever the outcome of the great debate over ordinary negligence versus scienter in private actions under 10(b) and Rule 10b-5, see *SEC* v. *Texas Gulf Sulphur*, *supra*, and the concurring opinions, it is clear that Judge Mansfield's instruction satisfied the scienter requirement imposed by prior cases.

VI—Causation

As is to be expected in difficult cases, appellants have urged a variety of arguments directed at the legion of rulings made during the course of the trial. Only a few of these merit discussion. Thus, appellants charge the jury was not properly charged on the element of causation in a violation of 17(a) or 10(b) and Rule 10b-5 and, concomitantly that there was insufficient evidence to show the misleading statement in question caused plaintiffs' losses. In essence, appellants assert that appellees must prove not only that the misleading statement caused them to purchase LRS stock but that the statement caused their economic loss by directly affecting the market price of LRS stock. It is interesting to note that the price of LRS began its decline after April 7, the date the SEC contracted Nixon

[18] Because we have concluded as a matter of law that punitive damages are not available for violations under § 17(a), we obviously need not determine if the evidence was sufficient to sustain the award of punitive damages. Rather we intend to indicate only that there was a surfeit of proof on the intentional nature of the violation.

Mudge and the Sperry Rand contract termination became more widely known.

It is sufficient for our purposes to recall that the court gave the jury clear instructions on causation. Thus he instructed

> "the plaintiff is required to prove by a fair preponderance of the evidence that he or she suffered damages as a proximate result of the alleged misleading statements and purchase of stock in reliance to them. In other words, the plaintiff must show that the misleading statement or omission played a substantial part in bringing about or causing the damage suffered by him or her and that the damage was either a direct result or a reasonably foreseeable result of the misleading statement."

Moreover, the jury was told to consider all the factors surrounding the misrepresentation in deciding if the plaintiffs' losses were caused by the misstatement. Because plaintiffs testified that they purchased the stock after being attracted by the name Sperry Rand in the offering circular and since the jury could have inferred that the price of the stock was bloated by the failure to disclose the true relationship between Sperry Rand and LRS, there was sufficient evidence to support a finding of causal relationship between the misrepresentation and the losses appellees incurred when they sold. Compare *List* v. *Fashion Park*, 340 F. 2d 407 (2d Cir.), cert. denied, 382 U.S. 811 (1965). Given this evidence, the jury could appropriately find the causal link. See Prosser, Torts 244 (3d ed. 1964). The instructions were sufficient to bring home the basic concept that causation must be proved else defendants could be held liable to all the world. Cf. *Bromberg, supra*, 817. See also *Vine* v. *Beneficial Finance Co., Inc.*, 374 F. 2d 627, 635 (2d Cir.), cert. denied, 389 U.S. 970 (1967); *Mutual Shares Corp.* v. *Genesco Inc.*, 384 F. 2d 540, 544 (2d Cir.

1967); *Barnett* v. *Anaconda Co.*, 238 F. Supp. 766, 776 (S.D.N.Y. 1965); 6 Loss, *supra*, at 3880-81.

Appellants also argue that the court distorted the question of causation by ruling that the schedule which the parties agreed would govern the amount of compensatory damages suffered assuming liability was proven, estopped defendants from contending that Globus (and perhaps others) suffered no actual loss since in Globus' case the stock was sold solely for the purpose of obtaining a tax loss. But, Judge Mansfield was correct in stating the issue to the extent of the loss the plaintiffs suffered as a result of their sale, not whether subsequent transactions in the stock led to a profit. Any other concept would prevent one from suing an issuer of stock even for the most flagrant violations. Globus' repurchase and admission that he sold for tax reasons was quite relevant to the issue of causation; but Judge Mansfield properly instructed the jury on that score.

VII—Remedy

We have carefully examined all the other points raised by appellants, relating to damages, replacement of counsel, etc. To avoid further extending this opinion already necessarily protracted because of the novel and important questions raised on this appeal, it is sufficient to state they have been carefully considered and we are in agreement with the determinations made by the able and experienced judge who presided over this difficult litigation.

In sum, we affirm the judgment below in all respects except the award of punitive damages on which we reverse.[19]

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[19] We do not believe the issue of punitive damages so permeated the record to the substantial prejudice of the appellants as to require a new trial on either the main issue of liability or the cross-claims for indemnity. Moreover, in accordance with Fed. R. App. P. 39(a) the parties will bear their own costs on appeal.

Judgment

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the eighth day of September, one thousand nine hundred and sixty-nine.

Present:

HON. STERRY R. WATERMAN,
HON. J. JOSEPH SMITH,
HON. IRVING R. KAUFMAN,
Circuit Judges.

65 Civil 1694

GLOBUS, INC., BARBARA D'AMATO, and MORTON GLOBUS, on behalf of themselves and all others similarly situated,
Plaintiffs,*

BLAIR & CO., and GRANBERY, MARACHE INCORPORATED,
Defendant and Third-Party Plaintiffs-Appellants,

v.

LAW RESEARCH SERVICE, INC., and ELLIAS C. HOPPENFELD,
Defendants-Appellants,

PAUL WIENER,
Third-Party Defendant-Appellee.

Appeal from the United States District Court for the Southern District of New York.

* The caption as to plaintiffs is incorrect. The correct caption is set forth on the cover pages of the opinions of the District Court and the Court of Appeals.

Judgment

This case came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed as to punitive damages and otherwise said judgment be and it hereby is affirmed without costs in accordance with the opinion of this court.

A. Daniel Fusaro
Clerk

[seal]

A true copy
A. Daniel Fusaro
Clerk

Judgment Entered 10/9/69

John Livingston
Clerk

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Supreme Court of the United States

OCTOBER TERM, 1969

No. 925

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,

Petitioners,

v.

LAW RESEARCH SERVICE, INC. and ELLIAS C. HOPPENFELD,

Respondents,

and

BLAIR & CO., GRANBERY MARACHE INCORPORATED,

Respondent and Third-Party Plaintiff,

v.

PAUL WIENER,

Third-Party Defendant.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENT AND THIRD-PARTY PLAINTIFF, BLAIR & CO., GRANBERY MARACHE, INCORPORATED

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

No. 925

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,

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BLAIR & CO., GRANBERY MARACHE INCORPORATED,

Respondent and Third-Party Plaintiff,

v.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENT AND THIRD-PARTY PLAINTIFF, BLAIR & CO., GRANBERY MARACHE, INCORPORATED

Respondent and third-party plaintiff Blair & Co., Granbery Marache Incorporated ("Blair") files this brief in opposition to the petition for a writ of certiorari filed by Morton Globus, et al. to review a judgment of the Court of Appeals for the Second Circuit rendered on September 8, 1969.

Question Presented

Whether in this case punitive damages are available as a remedy for a violation of §17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), in view of (a) the absence of any statutory authorization of such damages; (b) the verdict of the jury that respondents were not liable for common law fraud; and (c), as to Blair, the absence of clear, unequivocal and convincing evidence of any intentional wrongdoing by Blair.*

Statement

A. The Public Offering and Subsequent Disclosure of Facts Omitted From the Offering Circular

Blair is a brokerage and investment banking firm which engages in the underwriting and sale of securities to the public. On March 15, 1965, Blair made an offering to the public of 100,000 shares of Common Stock in Respondent Law Research Service, Inc. ("Law Research").

The offering was made pursuant to Regulation A of the Securities and Exchange Commission, 17 C.F.R.

* The Petition asserts that a similar question is raised under §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5, but no such issue was decided in the decision of the Court of Appeals for the Second Circuit which is the subject of the Petition. (See Argument I, *infra.*)

§§230.251 *et seq.*, and, in accordance with that regulation, an Offering Circular was prepared and distributed to the public. The Offering Circular was distributed by Blair under its name as underwriter (App. 617a-32a).* The preparation of the Circular and the consummation of the financing followed an investigation and evaluation of Law Research by Blair over a period of several months (App. 197a-203a).

As indicated in the Offering Circular, Law Research was a corporation engaged in the business of performing legal research for attorneys through the use of computers. Blair's first contact with Law Research was in the summer of 1964 when Respondent Ellias C. Hoppenfeld ("Hoppenfeld"), President of Law Research, was introduced to Malcolm Sanders, a Vice President of Blair, and indicated interest in obtaining financing for his company (Tr. 441). In the months that followed, Sanders met frequently with Hoppenfeld and the other officers of Law Research, and made extensive inquiry into its operations, *e.g.*, learning the names and addresses of Law Research subscribers, the dates of their contracts with Law Research and the number of orders from each. Sanders also made inquiries among law firms and bar associations as to the reputation of the company and its future prospects (App. 662a-64a; 202a-03a, 228a-30a).

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* The following abbreviations are used in this brief:

Pet. — Petition of Globus et al. for a Writ of Certiorari.

Op. Pet. — Decision of the United States District Court for the Southern District of New York, and Opinion of the United States Court of Appeals for the Second Circuit, reprinted in the Globus Petition.

App. — Joint Appendix filed on behalf of all the parties in the Court of Appeals.

Tr. — Trial transcript in the District Court.

Sanders learned that computer and programming services were performed for Law Research by Sperry Rand. He asked for, and obtained, a copy of the contract with Sperry Rand and discussed the operations and prospects of Law Research with the responsible Sperry Rand account executive (App. 198a-202a).

Sanders also advised Law Research that it would "be necessary for you to engage the services of a nationally recognized firm of auditors" which must certify the financial statements of Law Research "without exceptions" (App. 662a-64a). Arthur Young & Company was suggested to Hoppenfeld as one of the several accounting firms which would be acceptable and they were subsequently retained by Law Research (App. 203a-04a, 221a-22a).

The results of Sanders' investigations were summarized in a confidential memorandum to Blair on January 27, 1965, and, by letter dated February 4, 1965, Blair expressed its intention to go forward with the financing (App. 700a-05a; 665a-66a). Preparation of the Offering Circular then followed. The Circular was drafted by William Bailey, Esq., of the firm of Nixon Mudge Rose Guthrie Alexander & Mitchell on the basis of the information furnished to him and to Blair by Law Research (App. 421a-26a). It set forth, *inter alia*, a description of the company, its management and prior operations, a statement of the intended use of the proceeds, financial statements certified by Arthur Young & Company and various risk factors to be considered. It described the contract between Law Research and Sperry Rand and the cost of services under the contract, and also noted that Law Research was indebted to Sperry Rand in the amount of $82,285 for key-punching and other

services performed by Sperry Rand in setting up the law information retrieval program (App. 617a-32a).

On March 23, 1965, Blair, as underwriter, purchased the 100,000 shares of Common Stock from Law Research which had been offered to the public. In connection with the purchase, Blair received a certificate signed by Ellias C. Hoppenfeld and Paul Wiener, as officers of Law Research, and an opinion by Hoppenfeld, as counsel to Law Research, to the effect that the Offering Circular was accurate and complete in all material respects (Pl. Ex. 1; App. 231a, 658a-61a). In addition, under the terms of the Underwriting Agreement, Law Research agreed to indemnify Blair against any loss, damage or liability arising out of any untrue statement in, or the omission of any material fact from, the Offering Circular. However, it further provided that Blair would not be indemnified from any liability arising out of its own "willful misfeasance, bad faith, or gross negligence" (App. 711a-13a).

On April 7, 1965, counsel for Blair, William Bailey, received a telephone call from Frank J. Evangelist of the Securities and Exchange Commission. Mr. Evangelist advised Bailey that he had learned of a pending lawsuit by Law Research against Sperry Rand and inquired as to Bailey's knowledge of the suit. Bailey told Evangelist that it came as a complete surprise but that he would look into it (App. 429a-30a).

Immediately following the telephone call, a series of meetings were held by Blair and its counsel with Hoppenfeld and with Herman Goodman of The Franklin Corporation (which had loaned Law Research $125,000). (App. 213a-15a, 394a-99a, 429a; Tr. 527-31, 1051-53). In the course of the meetings, it appeared that:

(a) By letter dated January 25, 1965, Sperry Rand had advised Law Research that, unless it made payment of its indebtedness to Sperry Rand in the amount of $82,897 by January 29, 1965, Sperry Rand would consider the contract terminated (App. 667a-68a).

(b) On January 29, 1965, Law Research had commenced an action against Sperry Rand by service of a summons and, on February 23, 1965, Law Research had filed an affidavit by Paul Wiener charging Sperry Rand with, *inter alia,* breach of contract and fraud and deceit (App. 633a-40a).

After Hoppenfeld had made the foregoing disclosures, Malcolm Sanders and Emmons Bryant of Blair, Herman Goodman of The Franklin Corporation, and Hoppenfeld met with Sperry Rand and its counsel with a view to resolving the differences between that company and Law Research (App. 396a-98a). The discussions were successful and full settlement was reached between Law Research and Sperry Rand. The Law Research suit was discontinued with prejudice and a Supplemental Agreement, dated April 21, 1965, was entered into by Sperry Rand (Tr. 529; App. 681a-95a).

On April 22, 1965, Law Research sent to all stockholders a "Report From The President" which disclosed the existence of the dispute and its resolution (App. 680a). The language of the report was cleared with the Securities and Exchange Commission and the Commission took no action to suspend the Regulation A exemption of the stock (Pre-Trial Order, App. 8a; Tr. 1053-54).

B. Blair's Alleged Knowledge of the Facts Omitted From the Offering Circular

Malcolm Sanders, the Blair officer who was in charge of the underwriting, testified that, prior to the public offering, he had no knowledge of the purported termination by Sperry Rand, of any refusal by Sperry Rand to perform services for Law Research or of the pending lawsuit (App. 184a-87a, 233a-34a). Testimony to the same effect was given by Emmons Bryant, head of Blair's Corporate Department, and by William Bailey (App. 393a-95a, 427a-29a). Sanders, Bryant and Bailey all testified that they first learned of the foregoing facts only as a result of the inquiry from the Securities and Exchange Commission on April 7, 1965, and the meetings which followed (App. 213a-15a, 395a-96a, 429a-30a).

The testimony of Sanders, Bailey and Bryant was corroborated by Fred Johnston of Arthur Young & Company who testified that although he had been advised of a lawsuit, by a letter from Law Research dated February 23, 1965, he had not furnished a copy of the letter to Blair or its counsel, and had not informed them of its contents (App. 370a-73a). Johnston's testimony was also confirmed by a memorandum which he prepared in 1965 and which was subpoenaed by Law Research. The memorandum is a detailed summary of events and conferences concerning the status of the Sperry Rand contract. It plainly indicates that Johnston did not know of the purported termination by Sperry Rand and did not advise Blair or its counsel of the lawsuit commenced by Law Research (App. 706a-08a).

The sole support for a finding of actual knowledge on the part of Blair was provided by the testimony of Hop-

penfeld that he had advised Sanders in February 1965 that Law Research had served a summons on Sperry Rand. However, Hoppenfeld did not claim to have told Sanders the details of the suit or of the Wiener affidavit (App. 107a-12a). Furthermore, Hoppenfeld testified that he did not tell Blair that Sperry Rand had purported to terminate its contract with Law Research or that Law Research had charged Sperry Rand with fraud and deceit (App. 85a-86a, 99a-100a, 164a).

C. Claims for Relief and the Jury's Verdict

Claims for relief were asserted by the petitioners against all respondents under Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a) (1964) and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1964). In addition, claims were asserted against Blair under Sections 12(1) and 12(2) of the 1933 Act, 15 U.S.C. §§77 1(1) and (2) (1964), and Section 15(c) of the 1934 Act, 15 U.S.C. §78o(c) (1964). A claim for common law fraud was also asserted against all respondents under New York law.

The jury returned a verdict for each of the respondents on the claim of fraud asserted under New York law. However, they found for each of the petitioners on the claims asserted under Section 17(a) of the 1933 Act and Sections 10(b) and 15(c) of the 1934 Act and awarded total compensatory damages, including interest from June 3, 1965, in the amount of $32,591.14 against Law Research, Hoppenfeld and Blair, jointly and severally. In addition, they awarded "punitive damages" against Hoppenfeld in the total amount of $26,812.06 and against Blair in the total amount of $13,000 (Judgment, App. 593a-607a).

ARGUMENT

I.

The decision below does not raise the issue of whether punitive damages are available under the 1934 Act.

Petitioners attempt to bring themselves within this Court's Rule 19 (Considerations Governing Review on Certiorari) by introducing the extraneous question of whether punitive damages are available as a remedy under the Securities Exchange Act of 1934.*

The availability of punitive damages under the 1934 Act was not a question presented to the Court of Appeals in this case, and it was not the subject of the decision rendered by the Court of Appeals.

The Petition (p. 5, fn. **) acknowledges that this issue was not before the Court of Appeals by noting the following:

> "The Trial Court had instructed the jury that punitive damages were awardable under the 1933 Act, but not under the 1934 Act. Plaintiffs argued at trial that punitive damages were also awardable but, naturally, did not appeal that ruling in view of the jury's favorable award under the 1933 Act."

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* Thus, the Petition (p. 2) asserts that this case involves the following "Question Presented":

> "2. As a corollary question, although not vital to a determination of the primary question, whether in an appropriate case punitive damages are available as a remedy for a violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5."

Of course, the jury verdict did not award damages under the 1934 Act.

Thus, the "issues of great importance" noted at the outset of the Court of Appeals opinion (Op. Pet. A-24), and relied upon in the Petition (pp. 6-7) as the first reason for granting the Writ, do not include the issue of punitive damages under the 1934 Act.

The Court of Appeals, citing *Green* v. *Wolf Corp.*, 406 F.2d 291 (1968), *cert. denied* 395 U.S. 977 (1969); and *Meisel* v. *North Jersey Trust Co. of Ridgewood, N.J.*, 216 F.Supp. 469 (S.D.N.Y. 1963), merely restated in dictum its own previously established rule that "punitive, or exemplary damages, as they are sometimes called, are not available for violations of § 10(b) of the 1934 Act." (Op. Pet. A-34).

In a further attempt to bring themselves within this Court's Rule 19, Petitioners compound their misplaced reliance on the 1934 Act by arguing as a third reason for granting the Writ that "The Court of Appeals' decision creates uncertainty," (Pet. p. 9). Two of only four decisions cited to support this proposition are *Hecht* v. *Harris, Upham & Co.*, 283 F.Supp. 417 (N.D. Cal. 1968) and *de Haas* v. *Empire Petroleum Co.*, 302 F.Supp. 647 (D. Colo. 1969).

The *Hecht* case stated in a dictum that punitive damages might be allowed in a proper case based upon the 1934 Act, but concluded they were unnecessary in that case, 238 F.Supp. at 444-45. The *de Haas* opinion denied a motion to set aside a jury's award of punitive damages under Section 10(b) of the 1934 Act, 302 F.Supp. at 648-49, and the 1933 Act was not involved.

Thus, whatever uncertainty in the law might arguably arise from the *Hecht* and *de Haas* decisions, they involve issues which are not germane to the Petition or the decision below by the Court of Appeals.

II.

The decision below is clearly correct in holding that punitive damages are not available under the 1933 Act.

The Provisions of the Act. Neither the Securities Act of 1933 nor the Securities Exchange Act of 1934 contains any express provision affirmatively authorizing an award of punitive damages.

The 1934 Act does contain an express limitation on damages,* so the District Court concluded that punitive damages were not awardable under the 1934 Act (Op. Pet. A-7-8). See also, Op. Pet. A-34 and *Green* v. *Wolf Corp.*, *supra.*

Even though the 1933 Act does not contain an express limitation similar to Section 28(a) of the 1934 Act, a right to punitive damages under the 1933 Act cannot be implied and should not now be created judicially.

The Intention of Congress. Nothing in the legislative history of the 1933 Act suggests that Congress ever intended to create a right to punitive damages.

The District Court purported to derive a "legislative design" from the fact that the 1933 Act contains no limita-

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* Section 28(a) of the 1934 Act provides, in part, that "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb.

tion comparable to Section 28(a) of the 1934 Act (Op. Pet. A-8). Thus, the Court suggested that Congress deliberately undertook to make the 1934 Act less burdensome out of concern over a possible "strike" (*i.e.*, that issuers would seek to avoid the provisions of the Act by not listing new securities). On the contrary, however, the legislative history of the 1934 Act indicates that, to the extent that Congress was concerned by a possible "strike", it moved to meet that threat by regulating the over-the-counter market. (See H.R. Rep. No. 1383, p. 16, Sen. Rep. No. 792, p. 6, Sen. Rep. No. 1739, p. 3, H.R. Rep. No. 2601, p. 4, 73d Cong. 2d Sess. (1934)).

Moreover, it is clear that when the 1934 Act was enacted, Congress could not have believed that punitive damages were recoverable under the 1933 Act. As pointed out by Friendly, J., concurring in *SEC* v. *Texas Gulf Sulphur,* 401 F.2d 833, 867 (2d Cir. 1968), the unanimous view of commentators at that time was that Section 17(a) of the Act was intended to provide only a basis for injunctive relief or criminal liability and was not intended to supplement the civil liabilities created by Sections 11 and 12 of the Act. And the civil liabilities imposed by Sections 11 and 12 of the Act were, by their terms, limited to compensatory damages.

In any event, there is no indication that the language of Section 28(a) of the 1934 Act reflected a belief by Congress that punitive damages were allowable under the 1933 Act. Congress could easily have provided expressly for such damages under the 1933 Act if that had been intended.

In *United Mine Workers of America* v. *Patton,* 211 F.2d 742 (4th Cir. 1954), the court rejected a claim for punitive damages asserted in connection with a claim under the

Federal Labor Management Relations Act. Pointing out that the statute made no provision for damages, the court observed that, where Congress had intended to create a right to such damages, as in the patent and anti-trust fields, "it has found no difficulty in using language appropriate to that end." *Id.* at 749. Similarly, in *Burris* v. *International Brotherhood of Teamsters,* 224 F.Supp. 277 (W.D.N.C. 1963), the court held that "absent express Congressional intention punitive damages [are] not recoverable when invoking the jurisdiction of the court on a federally created cause of action." *Id.* at 280. Accord, *Cole* v. *Hall,* 35 F.R.D. 4 (E.D.N.Y. 1964).*

While we fully concur with the decision of the Court of Appeals in denying punitive damages based upon a broader analysis of the role they would play in the statutory scheme established for the enforcement of the Securities Act (Argument V, *infra*), we also submit that the decision below is clearly correct based upon the language and history of the Act and established rules for statutory construction.

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* The District Court found some authority for the proposition that punitive damages may be awarded in a federal action without express legislative authority. (See *Mansell* v. *Saunders,* 372 F.2d 573 (5th Cir. 1967); *Basista* v. *Weir,* 340 F.2d 74 (3d Cir. 1965); *In re Den Norske Amerikalinje A/S,* 276 F.Supp. 163 (N.D. Ohio 1967). However, we submit that the conclusion reached in the *United Mine Workers* and *Burris* cases is the better reasoned view and should be followed here. It is significant that *Mansell* v. *Saunders, supra; Basista* v. *Weir, supra;* and *In re Den Norske Amerikalinje A/S, supra,* each involve a non-commercial situation in which punitive damages were awarded to a small and distinct number of persons who had suffered serious personal injury or deprivation of constitutional rights under extremely aggravated circumstances. No other type of case has allowed punitive damages under a federal statute in the absence of express legislative authority. Compare the decision below, Op. Pet. at A-38-39, and *Roginsky* v. *Richardson-Merrell, Inc.,* 378 F.2d 832, 838-40 (2d Cir. 1967) where larger classes of potential plaintiffs are involved.

III.

The decision below is not in conflict with other case law.

Petitioners argue that "the Court of Appeals' Decision creates uncertainty" (Pet. p. 9). Two of the four cases upon which this assertion is based, *Hecht* v. *Harris, Upham & Co., supra,* and *de Haas* v. *Empire Petroleum Co., supra,* involve only the Securities Exchange Act of 1934, and therefore raise issues which are in no way germane to the petition (See Argument I, *supra*).

The third case said to create "uncertainty," *Green* v. *Wolf Corp.,* 406 F.2d 291 (2d Cir.), *cert. den.* 395 U.S. 977 (1969), contained the dictum that punitive damages might be allowable under the 1933 Securities Act (citing the District Court opinion in this case), but this dictum was unequivocally repudiated by the same Court of Appeals in this case.*

The fourth case said to create "uncertainty," *Nagel* v. *Prescott & Co.,* 36 F.R.D. 445 (N.D. Ohio, 1964), did not sanction punitive damages under any federal securities

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* "Our opinion in *Green* v. *Wolf Corp., supra,* does contain some language indicating such a dichotomy does exist and that punitive damages may be permissible under the 1933 Act. 405 F.2d at 303. However, it is obvious to the careful reader that this was merely dicta intended to limit the holding in *Green* to the specific issue then before the court, i.e. the validity of punitive damages in an action based on § 10(b) and Rule 10b-5 of the 1934 Act and not as approval for the award of punitive damages under the 1933 Act. As we have demonstrated, *supra,* the reasoning of *Green* is completely consistent with our holding here. As to the legislative history on which Judge Mansfield purported to base the discrepancy between the two acts, see 54 Va. L. Rev. 1500 (1968)." (Op. Pet. A-40)

laws, but held that such damages might be awardable in a tort action based on Ohio law.

In *Nagel,* the court recognized that "there is no provision in the Securities Act authorizing recovery of punitive damages. . . ." *Id.* at 449. However, the court indicated that, by reason of the "savings clause" of the Act, punitive damages could be allowed to the extent permitted by state law.* The court then analyzed Ohio law and concluded that Ohio would allow the imposition of punitive damages under the facts there alleged.

It is not necessary to linger over the propriety of a rule which allows an award of punitive damages under state law when the underlying cause of action is based upon the federal securities laws. Under the applicable state law in this case, that of New York, it is clear that punitive damages are not allowable.

Prior to *Walker* v. *Sheldon,* 10 N.Y.2d 401 (1961), it was well settled in New York that punitive damages were not allowed in fraud cases. *Oehlhof* v. *Solomon,* 73 App. Div. 329, 76 N.Y. Supp. 716 (1st Dept. 1902); *Toho Bussan Kaisha, Ltd.* v. *Am. President Lines,* 265 F.2d 418, 76 A.L.R. 2d 1344 (2d Cir. 1959). In *Walker* v. *Sheldon,* the New York Court of Appeals carved out a limited exception under the following circumstances:

> "The pleading charges that defrauding the general public into entering publishing contracts, such as the one involved in the present case, was the very basis

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* Section 16 of the 1933 Act, 15 U.S.C. § 77p (1964), provides that:

> "The rights and remedies provided by this subchapter shall be in addition to any and all other rights and remedies that may exist at law or in equity."

> of the defendant's business. What is asserted is not an isolated transaction incident to an otherwise legitimate business, but a gross and wanton fraud upon the public." 10 N.Y.2d at 406, 223 N.Y.S.2d at 492.

The dissimilarity of the present case to *Walker* v. *Sheldon* is striking. Whatever view is taken of the facts alleged and proved herein, it is undisputed that the Law Research offering was no more than an isolated transaction incident to the admittedly legitimate business of Blair. The inapplicability of *Walker* v. *Sheldon* is further underscored by the fact that the jury's verdict for respondents on the common law fraud claim was clearly based on a finding that there was no proof of an intent to defraud.

In *Walker* v. *Sheldon,* the assumption of an intent to defraud was central to the rationale of the court in permitting the award of punitive damages:

> "Exemplary damages are more likely to serve their desired purpose of deterring similar conduct in a fraud case, such as that before us, than in any other area of tort. One who acts out of anger or hate, for instance, in committing assault or libel, is not likely to be deterred by fear of punitive damages. On the other hand, those who deliberately and coolly engage in a far-flung fraudulent scheme, systematically conducted for profit, are very much more likely to pause and consider the consequences if they have to pay more than the actual loss suffered by an individual plaintiff." 10 N.Y.2d 406.

Clearly, one cannot "deliberately and coolly engage in a far-flung fraudulent scheme" without an intent to defraud.

In sum, there is no basis within the case law applying the federal securities acts for permitting the award of punitive

damages. And even if one accepts the rather doubtful thesis of *Nagel* v. *Prescott & Co., supra,* that state law may be invoked to permit the award of punitive damages, it is perfectly clear that the law of New York would not permit punitive damages to be awarded under the facts of this case.

No other cases noted by Petitioner suggest a conflict between the decision below on punitive damages and other case law, and we know of none.

IV.

The decision below is in accord with the teachings of this Court.

The Petition (pp. 7-9) asserts that there is an inconsistency between the decision of the Court of Appeals and the decision of this Court in *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) and two cases quoted in *Case* v. *Borak, Bell* v. *Hood,* 327 U.S. 678 (1946) and *Deckert* v. *Independence Shares Corp.,* 311 U.S. 282 (1940). The principle which Petitioners correctly derive from these cases is that the courts should be alert to provide remedies to make federally secured rights effective.

The point is that as to these Petitioners the Court of Appeals did have the power and did "make the right of recovery effective," *Deckert* v. *Independence Shares Corp., supra,* 311 U.S. at 288; and the Court of Appeals was able to and did "grant the necessary relief," *Bell* v. *Hood, supra,* 327 U.S. at 684; and the Court of Appeals has "provide[d] such remedies as are necessary to make effective the congressional purpose," *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 433.

The jury awarded to Petitioners an aggregate sum of $32,591.14 in compensatory damages. This verdict was allowed by the District Court and by the Court of Appeals, and no effort has been made to challenge it in this Court. No assertion is made in the Petition that these compensatory damages were insufficient in amount.

In *S.E.C.* v. *Capital Gains Bureau*, 375 U.S. 195 (1963), also relied upon in the Petition (p. 8), this Court again applied securities legislation "not technically and restrictively, but flexibly to effectuate its remedial purposes." There again, the Court was concerned with providing an effective remedy where, unlike the present case, the court below had found that no remedy was available.

Moreover, in the present case, the Court of Appeals has not been "technical and restrictive"; rather, it has based its decision on an extensive analysis of the role which punitive damages would play in the entire statutory scheme established for the enforcement of the Securities Act. (See Op. Pet. A-36-41).

V.

The Court below correctly held that punitive damage recoveries are not necessary for the effective enforcement of the 1933 Act.

We submitted in Argument II, *supra,* that the decision below is clearly correct based on the language and history of the Securities Act of 1933. The Court of Appeals also concluded as follows:

> "Since even in this day of easily implied liability under the securities acts, it is not settled to everyone's satisfaction that compensatory damages are authorized by 17(a), it would no doubt jolt and startle the draftsmen of the 1933 Act to be told that they also authorized the recovery of punitive damages when that section was formulated." (Op. Pet. A-36.)

The Court of Appeals further concluded, however, that "neither Congressional mind-reading nor stenciling the bounds of the express liability sections onto § 17(a) provide a firm basis for decision" (*ibid.*), and that "the seminal question is whether punitive damage recovery is necessary for the effective enforcement of the Act" (Op. Pet. A-37).

The court below has correctly answered this "seminal question".

The "arsenal of weapons" necessary to perform the functions of retribution and deterrence under the Act are sufficient without punitive damages.

> "The 1933 Act provides not only for a fine but five years imprisonment for those who violate 17(a). 15

U.S.C. §77x. Moreover, the SEC may suspend or expel those who violate the securities acts or suspend trading in a particular stock. Furthermore, private actions often lead to sizable recoveries and to considerable deterrent clout. In *Green* v. *Wolf Corp., supra,* we recognized that a class action under Fed.R.Civ.P. 23 could be particularly effective and appropriate in remedying violations of the securities acts when the injury to any individual was not large enough to provoke him to legal action. Thus a recurring rationale for punitive damages—that the lure of a windfall is required to encourage suits to enforce the Act—has lesser impact where the class action for the small litigant would be appropriate. Compensatory damages, especially when multiplied in a class action, have a potent deterrent effect. And there always lurks the psychological deterrent of being branded a knowing violator of the law. This is particularly true in an industry where, as the sages put it, a good name is worth more than a crown. Cf. *Stevens* v. *Abbott, Proctor & Paine,* 288 F. Supp. 836 (E.D. Va. 1968)." (Op. Pet. A-37-38.) (Footnote omitted.)

Against this unneeded or "marginal" deterrent the Court of Appeals weighed "the potentially awesome injuries that [punitive] damages may impose" on "an otherwise honest underwriter or issuer who egregiously erred in one instance which affected many" (Op. Pet. A-38).

The recent decision of the Court of Appeals for the Second Circuit in *Roginsky* v. *Richardson-Merrell, Inc.,* 378 F.2d 832, 838-42 (1967), provides compelling reasons why, at least in the absence of a clear legislative mandate, punitive damages should not be made available under the type of claim asserted in the present action.

"In *Roginsky* * * * this court denied punitive damages in an action charging a drug manufacturer with

irresponsibility in marketing a drug which injured hundreds of people. The opinion emphasized that punitive damages are normally awarded in situations where there is only a single injured party and thus the total amount of punitive damages may be kept to a reasonable level. A single misstatement or omission in a prospectus or offering circular, although less dangerous than a drug, may leave those responsible liable to literally thousands of purchasers.

"Nor does there appear to be any way for us to fairly restrict the punitive award. It may not always be possible to circumscribe all possible plaintiffs in a single suit. Nor can we predict how many suits will arise from any particular violation. And, as *Roginsky* points out, 'We know of no principle whereby the first punitive award exhausts all claims for punitive damages and would thus preclude future judgments.' 378 F.2d at 839. Even if such a principle were valid we would have some doubt about the propriety of providing a windfall to the first litigant to chance upon a sympathetic jury." (Op. Pet. A-38-39.) (Footnotes omitted.)

Finally, the Court of Appeals noted that:

"To permit punitive damages under the 1933 Act would create an unfortunate dichotomy between the 1933 and 1934 Acts. Section 28(a) of the 1934 Act prohibits punitive damages in actions brought under that Act. But the 1934 Act is the only basis upon which defrauded sellers of securities could obtain relief, see *Royal Air Properties* v. *Smith,* 312 F.2d 210 (9th Cir. 1962); 17(a) of the 1933 Act by its terms only provides protection to purchasers of stock who are damaged by fraud. Allowing exemplary damages under the 1933 but not under the 1934 Act would create an unreasoned split between buyers and sellers of securities subjected to fraud of an equally heinous nature.

"To avoid such inconsistencies, courts have endeavored to treat the '33 and '34 Acts *in pari materia* and to construe them as a single comprehensive scheme of regulation." (Op. Pet. A-39-40.) (Footnote omitted.)

We respectfully submit that the court below has properly delineated that "single comprehensive scheme of regulation" as it applies to this case.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be denied.

Respectfully submitted,

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January 19, 1970

CERTIFICATE OF SERVICE

I, DONALD J. ZOELLER, hereby certify that copies of the foregoing Brief in Opposition for Respondent and Third-Party Plaintiff, Blair & Co., Granbery Marache Incorporated, have been served on counsel by mailing copies by United States mail, postage prepaid, to Herman E. Cooper, Esq., Messrs. Cooper, Ostrin, DeVarco & Ackerman, Counsel for Petitioners, 655 Madison Avenue, New York, New York 10021, and Alfred S. Julien, Esq., Messrs. Julien, Glaser & Blitz, Counsel for Respondents other than Blair, 2 Lafayette Street, New York, New York 10007, this 19th day of January, 1970.

DONALD J. ZOELLER

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Supreme Court of the United States

October Term, 1969

No. 925

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,
Petitioners,

against

LAW RESEARCH SERVICE, INC. and ELLIAS C. HOPPENFELD,
Respondents,

and

BLAIR & CO., GRANBERY MARACHE INCORPORATED,
Respondent and Third-Party Plaintiff,

against

PAUL WIENER,
Third-Party Defendant.

BRIEF OF RESPONDENT, ELLIAS C. HOPPENFELD, IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Supreme Court of the United States

OCTOBER TERM, 1969

No.

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,
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BRIEF OF RESPONDENT, ELLIAS C. HOPPENFELD, IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Counter-Statement of Question Presented

Whether punitive damages are available as a remedy for a violation of §17 (a) of the Securities Act of 1933, 15 U. S. C. §77q(a).

Counter-Statement of Facts

The plaintiffs, all former purchasers of stock in Law Research Service, Inc., brought this action against Law Research Service, Inc.,* the issuer of the stock, Ellias C. Hoppenfeld, its president and director, and Blair & Co., Granbery, Marache, Inc.,** the underwriter of the public stock offering for common law fraud and for violations of Sections 17a and 10b of the 1933 and 1934 Federal Securities Acts and Rule 10-6-5 of the Securities and Exchange Commission on the grounds that said defendants allegedly issued an offering circular effective March 15, 1965, in which there were material omissions of fact which, had they been known to the plaintiffs, would have prevented them from purchasing the stock and on the further ground that each of said plaintiffs suffered a loss as the result of his or her purchases and sales of the stock.

The offering circular contained a statement that L.R.S. had entered into a five year contract with Sperry Rand, under which Sperry Rand was to provide various services in connection with L.R.S.'s computerized legal research service (Ex. 2). The offering circular also made it clear that L.R.S. stock was a highly speculative investment and that, at the time of the offering, L.R.S. was indebted to Sperry Rand in the amount of $82,285 for services rendered by Sperry Rand, which debt—or such portions of it as could not be deferred—would be paid from the proceeds of the public stock offering and with the aid of loans from two lending institutions (Ex. 2, 619a, 621a).

The alleged material omission was that the circular failed to state that a dispute had arisen between L.R.S. and Sperry Rand in the course of which Sperry Rand had

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* Hereinafter referred to as L.R.S.

** Hereinafter referred to as Blair & Company or Blair.

allegedly terminated the contract and refused to render further services and L.R.S. had commenced suit against Sperry Rand.

L.R.S. and Hoppenfeld contended, on the other hand, that there had been no material omission; that Sperry Rand had never terminated the contract; that Sperry Rand had never ceased performing any essential service required by the contract; that the dispute concerned primarily the payment of the debt which, in any event, was disclosed in the offering circular; that Hoppenfeld had been advised by Arthur Young & Company, the auditors, and by Blair & Company and Nixon, Mudge, Rose, Guthrie, Alexander & Mitchell,* Blair's counsel, that suits brought by the issuing corporations—as distinguished from suits against it—were not material and, therefore, were not required to be noted in the offering circular.

Hoppenfeld discussed the dispute and the lawsuit fully with both Sanders of Blair & Company and Johnston of Arthur Young & Company during the month of February, 1965, and, at a due dilegence meeting in Hoppenfeld's office on or before February 23, called by Johnston who described it as a final meeting of all parties prior to the issuance and underwriting at which all recent events were to be disclosed, Hoppenfeld showed Johnston all of the Sperry Rand correspondence, (Tr. 120-121, 160-161, 178-182, 234-236, 238-241, 244-246, 309-310, 336, 360-363, 896-897, 919-920, 965-966; 53a-55a, 77a, 80a-85a, 103a-110a, 113a-115a, 126a-128a, 143a-144a, 161a-163a, 360a-362a, 383a-384a).

Sanders of Blair & Company was not present, but Johnston, who had been doing investigation for Blair & Company all along and who had been having conferences with Bailey of Nixon Mudge, counsel to Blair & Company, in regard to the audit and investigation of L.R.S., advised Hoppenfeld that he was representing both Blair & Com-

* Hereinafter referred to as Nixon Mudge.

pany and Arthur Young & Company at the meeting (Tr. 178-182, 247, 307-308, 317-319, 324-326, 352-353, 360-365, 955-959, 1044, 1057; 80a-85a, 116a, 124a-126a, 133a-134a, 139a-142a, 155a-157a, 161a-164a, 375a-380a, 423a-424a, 431a).

Hoppenfeld discussed the question of whether mention of the lawsuit against Sperry Rand should be made in the offering circular with both Johnston and Sanders as well as with Bailey and he was advised by all of them that only suits *against* the issuing company were material and required to be disclosed in an offering circular and that his suit against Sperry Rand, in view of the fact that L.R.S. was the plaintiff rather than the defendant, was not a material fact and did not have to be noted in the offering circular (Tr. 241, 336-339, 342-345, 474, 965-966; 110a, 143a-147a, 149a-153a, 383a-384a).

Hoppenfeld, an attorney who had had no experience in the area of securities transactions or regulation, had relied on the expertise of Blair, Nixon Mudge, and Arthur Young & Co.; and L.R.S. and Hoppenfeld had at all times acted in good faith.

Moreover, defendants contended that many of the plaintiffs, including Morton Globus, had made a profit rather than suffered a loss as the result of their transactions in L.R.S. stock.

The jury returned verdicts in favor of the defendants in the cause of action for common law fraud and in favor of each of the plaintiffs in the causes of action based upon statutory violation.

The jury also returned verdicts for punitive damages against each of the defendants in the amount of $1,000 for each plaintiff and, upon being sent out again to reconsider the verdicts and add legal fees, the jury returned even larger verdicts for punitive damages despite the fact that no evidence whatsoever had been adduced by the plaintiffs in regard to the type, value or cost of legal services rendered to them.

1. Argument

The issue in the present case is uniquely narrow and no amount of strained semantics can convert it into one warranting review by this Court on certiorari. Of all the sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 we are here concerned only with one of them, the Securities Act of 1933, and whether punitive damages are available as a remedy for violation of §17 (a) of the Securities Act of 1933, 15 USC Section 77q (a) 1964 (A-35).* The Court of Appeals decision on this issue was manifestly correct. The Court of Appeals in discussing the issue of punitive damages clearly sets forth in its decision (A-35) that if it was the intent of Congress to have included punitive damages as a remedy under §17 (a) then Congress would have found no difficulty in using language appropriate to that end (A-35). As the Court of Appeals indicated, §17 (a) was to serve only as a basis for criminal or injunctive action (A-35).

There is no important question of Federal law requiring decision by this Court. The decision of the Court of Appeals on the issue of punitive damages is clear and concise not only as to the issue that punitive damages have no application in §17 (a) of the Act, but additionally the Court discussed in detail the basis for its ruling that punitive damages are not recoverable under §17 (a) of the Securities Act of 1933.

Although the issue of punitive damages has been discussed by many brief writers and students of the law, there is no evidence to support the contentions made by the petitioner in his brief of the "Plethora of Security Acts law suits now abounding", which petitioner claims require a determination by the Supreme Court.

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* "A" and number designate page in the appendix to petitioner's petition for certiorari.

Contrary to the petitioner's assertion that the Supreme Court should determine conflicting decisions in lower courts, the Court of Appeals in its well reasoned and detailed opinion has determined the applicable law and has clarified the law applicable to punitive damages under the 1933 Act (A-39). It characterized its statement in *Green* v. *Wolf Corp., infra,* as dicta which did not affect the consistency between its two holdings.

The petitioner requests a review of the principles set down in *Green* v. *Wolf Corp.*, 406 F. 2d 291 (2d Cir. 1968), cert. denied, 395 U. S. 977 (1969), denying punitive damages under the 1934 Act even though he conceded that he neither disagreed with the ruling by the District Court on that issue nor raised that issue in the appeal before the Court of Appeals.

The request at this late date that this court review the issue of punitive damages under the Securities Act of 1934 is an indication of the weakness of petitioner's petition for review of the 1933 Act as well as of the 1934 Act.

Interestingly, the Court of Appeals in the decision that is the subject of the petition, supported its finding on the 1934 Act clearly and concisely, setting forth the reason for its holding (A-35), as well as setting forth that its finding in this case is not in conflict in any way with its opinion in *Green* v. *Wolf, supra.*

2. The Court of Appeals' decision does not ignore and is not in conflict with the teachings of the decisions of this Court.

The petitioner alleges that the Court of Appeals has ignored the teachings of the Supreme Court in *J. I. Case Co.* v. *Borak,* 377 U. S. 426 (1964). He concedes that *J. I. Case Co.* v. *Borak, supra,* involves the 1934 Act and goes on to indicate those areas in which he alleges the Court of Appeals has ignored the teachings of this Court which are:

> "The protection of investors," . . . and with reference to activities of the Federal courts that they should . . . "adjust their remedies so as to grant the necessary relief. . . ."

Quite to the contrary, the Court of Appeals has followed the teaching of the Supreme Court in the aforesaid case when they inferred that there should be no discrimination between one group of investors and another, but should encompass all investors equally (A-38).

Following the teachings of this Court, the Court of Appeals found that "smart money" as a result of punitive damages could provide a windfall to the initial litigant to the detriment and injury of all other investors (A-39).

At page 8 of the brief, petitioner erroneously alleges that the Court of Appeals has failed to follow the teachings of the Supreme Court in *Deckert* v. *Independence Shares Corp.*, 311 U. S. 282 (1940).

The specific language which the petitioner alludes to is as follows:

> "The power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case."

The petitioner argues that an action for punitive damages is normally available to the litigant in an appropriate case, and therefor the Court of Appeals has failed to follow the teachings of the Supreme Court. In fact, the Court of Appeals has followed the teachings of the Supreme Court in the *Deckert* v. *Independence Shares Corp.*, *supra*, and has specifically indicated that fact in its decision and has stated contrary to the statements of the

petitioner in holding that ordinarily punitive damages are *not* awarded in situations where there is more than one injured party (A-38).

Finally, the petitioner on page 8 alleges that the Court of Appeals ignored the teaching of this Court in *S. E. C.* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963), when it allegedly failed to follow the Court's direction in interpreting the intent of Congress with reference to the Securities Legislation to:

> "Not technically and restrictively but flexibly to effectuate its remedial purpose."

Again, petitioner is in error, the Court of Appeals has followed the teachings of the Supreme Court in determining that punitive damages or "smart money" (A-38) would not actually serve the remedial purpose against an otherwise honest issuer who egregiously erred in one instance. There can be no question that a remedy that will punish innocent purchasers, i.e., the stockholders of the issuer who are not parties to the litigation, clearly does not serve a remedial purpose and will not effectuate the teachings of *S. E. C.* v. *Capital Gains Research Bureau, Inc., supra.*

3. The Court of Appeals' decision creates no uncertainties.

Contrary to the facts petitioner erroneously argues that the Court of Appeals' decision has created uncertainties as to whether or not punitive damages are allowable under §17(a) of the 1933 Act.

The language of the Court of Appeals in this area is specific and concise. It has stated unequivocally that:

> "We have found that §17(a) of the 1933 Act does not support punitive damages for several reasons" (A-39).

In further clarification of the finding above quoted, the Court states in footnote 10 to A-39:

> *"The interests of justice are clearly served by announcing the rule we consider applicable for all cases under this section"* (italics ours).

The petitioner at page 9 of his brief indicates that the Court of Appeals alleges uncertainties by reason of the alleged contradictory statement in *Green* v. *Wolf, supra.* The Court of Appeals themselves have clarified this issue at page A-40 and have stated unequivocally that *Green* v. *Wolf, supra,* is completely consistent with the holding in the case herein when the Court stated on page A-40 fn. 12:

> "[12] Our opinion in *Green* v. *Wolf Corp., supra,* does contain some language indicating such a dichotomy does exist and that punitive damages may be permissible under the 1933 Act. 406 F. 2d at 303. However it is obvious to the careful reader that this was merely dicta intended to limit the holding in *Green* to the specific issue then before the court, i.e. the validity of punitive damages in an action based on §10(b) and Rule 10b-5 of the 1934 Act and not as approval for the award of punitive damages under the 1933 Act. As we have demonstrated, *supra,* the reasoning of *Green* is completely consistent with our holding here. As to the legislative history on which Judge Mansfield purported to base the discrepancy between the two acts, see 54 Va. L. Rev. 1560 (1968)."

In addition, petitioner is attempting to raise in this Writ of Certiorari a request for review of the holdings in *Green* v. *Wolf, supra.* This is contrary to the teaching of this Court in *Sherman* v. *U. S.*, N. Y. (1958), 78 S. Ct. 819, 356 U. S. 369, 2 L. Ed. 2d 848, which held that the United States Supreme Court does not ordinarily decide issues

not presented by the parties. See also *Lawn* v. *U. S.*, N. Y. (1958), 78 S. Ct. 311, 355 U. S. 339, 2 L. Ed. 2d 321, rehearing denied 78 S. Ct. 529, 355 U. S. 967, 2 L. Ed. 2d 542; *Sonzinsky* v. *U. S.*, Ill. (1937), 57 S. Ct. 554, 300 U. S. 506, 81 L. Ed. 772.

The petitioner concedes and the Court of Appeals states that there is an "arsenal of weapons" available under the Securities Acts, including express criminal, injunctive and administrative remedies. The Court of Appeals very properly found that it is not inherently necessary or desirable to include in the arsenal the extraordinary and little used sanction of punitive damages.

In the case at bar, the Securities and Exchange Commission itself conducted a complete examination and investigation of all the facts and of the individuals involved, within three weeks after the alleged misrepresentations were made in the offering circular, and with all the remedies at its command, the S. E. C. found that the post-distribution letter to be sent to stockholders was all that was warranted under the circumstances.

This is a fair indication and lends substance to the contentions of the Court of Appeals when it voices its fears of the "overkill danger" of punitive damages (A-39 fn. 10).

CONCLUSION

It is, therefore, respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

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